

**Supporting Statement for the
Survey of Terms of Lending (OMB No. 7100-0061):
Survey of Terms of Business Lending (FR 2028A),
Survey of Terms of Bank Lending to Farmers (FR 2028B), and
Prime Rate Supplement to Survey of Terms of Lending (FR 2028S)**

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 minor revision, the quarterly Survey of Terms of Lending (STL; FR 2028; OMB No. 7100-0061). The voluntary STL collects unique information concerning both price and certain nonprice terms of loans made to businesses and farmers during the first full business week of the mid-month of each quarter (February, May, August, and November). The survey comprises three reporting forms: the FR 2028A, Survey of Terms of Business Lending; the FR 2028B, Survey of Terms of Bank Lending to Farmers; and the FR 2028S, Prime Rate Supplement to the Survey of Terms of Lending. The FR 2028A and FR 2028B collect detailed data on individual loans made during the survey week, and the FR 2028S collects the prime interest rate for each day of the survey from both FR 2028A and FR 2028B respondents.

From these sample STL data, estimates of the terms of business loans and farm loans extended during the reporting week are constructed. The aggregate estimates for business loans are published in the quarterly E.2 release, *Survey of Terms of Business Lending*, and aggregate estimates for farm loans are published in the quarterly E.15 release, *Agricultural Finance Databook*.

The Federal Reserve proposes to revise the FR 2028A by increasing to \$7,500 the minimum loan size that must be reported and to clarify the instructions about reporting certain types of loans. These revisions would be implemented effective for the February 2009 survey week. No changes are proposed to the FR 2028B or FR 2028S. The annual reporting burden for the proposed STL reports is estimated to be 6,840 hours; a 6.5 percent decrease from the current burden of 7,317 hours. Copies of the proposed FR 2028A reporting form and instructions are attached.

Background and Justification

The FR 2028A was designed to allow the Federal Reserve to measure the cost of business borrowing from banks and to analyze developments in bank loan markets. It replaced the Quarterly Interest Rate Survey and portions of the Survey of Selected Interest Rates of the Committee on Interest and Dividends (CID survey). It was designed to provide more accurate and detailed information on business loans, especially concerning maturity and nonprice terms, than the aforementioned surveys.¹ The FR 2028B, which replaced the farm loan portion of the CID survey, collects data on the cost and characteristics of farm borrowing from banks. In many areas of the nation, farm lending is the primary form of business lending by commercial banks. The volume and

¹ Construction and land development loans were originally included in the STL but were dropped from the survey in 1989.

terms of such lending are affected by, and in turn affect, developments and trends in the agricultural sector of the economy.

Analysis of the STL data provides reliable estimates of the cost of important segments of business and agricultural credit at banks that are representative of banking institutions nationwide. Currently, it is the Federal Reserve's only available source of data on bank loan pricing for individual loans of all sizes. Since its inception in February 1977, the STL has been revised periodically to accommodate changes in lending practices.

In 1997, the FR 2028A respondent panel was expanded to include U.S. branches and agencies of foreign banks. At the same time, interest rate adjustments and maturity items were added and redefined, and a risk-rating item was added to both the FR 2028A and the FR 2028B. In addition, the prime rate supplement data, previously collected from respondents to the business loan survey, were collected from respondents to the farm loan survey as well.

In 2003, the FR 2028A was modified: a field for the date on which the terms, including pricing, for loans made under formal commitment became effective was added, the number of base pricing rate options was reduced from five to two, and the data item indicating whether loans are callable was deleted. The renewal also entailed a modification in the format of the recalculation and maturity date items for both the FR 2028A and FR 2028B and some minor clarifications to the instructions.

In 2006, for both the FR 2028A and FR 2028B the minimum size of loans reported was increased from \$1,000, a level at which it had been held since the inception of the STL in 1977, to \$3,000. The adjustment reflected price inflation over the intervening period and the increased use of business credit cards, developments that likely had added significantly to the burden of reporting small loan amounts.

Business Loan Survey (FR 2028A)

As an ongoing source of timely information, the survey data are used to assess current conditions and to track developments in short-term business credit markets. The results are reported to the Federal Reserve Board in regular economic reviews and to the Federal Open Market Committee in Greenbooks and Bluebooks. The survey data have been highly useful for monitoring the changing role of the prime rate as a benchmark for business loan pricing and of shifts in the mix of fixed-rate and variable-rate lending as financial markets have changed. Beyond their use for current analysis, these data have been critical to a number of special studies. The STL microdata are not available to researchers outside the Federal Reserve System.

Data from the STL provided the Federal Reserve with valuable information on loan pricing behavior during the credit market turmoil that began in the second half of 2007. For example, the STL data for late 2007 and early 2008 showed a smaller increase in the spread of loan rates over banks' cost of funds than other indicators of business loan pricing suggested. Likewise, the STL was a valuable source of information on credit availability during the economic slowdown of 1990-91, a period which, according to many observers, was characterized by restrictions in the supply of credit from banks. In particular, the STL data showed that high lending rates were more pronounced

and persistent on small and mid-sized loans than large loans during the 1990-91 period. In each case, the scope of the loan data collected in the STL provided insights unavailable through any other existing sources. STL data have also been used in scholarly research into the 1990-91 slowdown and the monetary transmission mechanism in general.²

The Federal Reserve has used the STL data to study the likely effects of bank consolidation on bank lending patterns and to improve our understanding of bank lending practices near the century date change. A study of the effects of consolidation, published in the fall 1995 *Brookings Papers on Economic Activity*, used information on the volume and pricing of individual banks' loan extensions, as well as balance sheet information from the quarterly commercial bank *Consolidated Reports of Condition and Income* (FFIEC 031 and 041; OMB No. 7100-0036) (Call Reports) to assess the likely effects of industry consolidation on the availability and pricing of small business loans.³ This study would not have been possible without the detailed information on individual loans available from the STL. Similarly, internal work at the Federal Reserve on banks' willingness to extend credit during the months immediately preceding and following the century date change employed data from the STL in an effort to understand the importance of banks' ability to closely monitor their customers' preparations and vary loan terms accordingly relative to other providers of credit during that period.

The addition of loan risk ratings to the survey in 1997 has proven particularly useful. The Federal Reserve used the data to investigate the prevalence and quality of banks' risk rating systems, as well as their ability to price risk appropriately and adjust other loan terms for risk.⁴ The authors found that larger banks had more detailed risk rating systems, but that all banks generally charged higher rates on riskier loans after adjusting for other loan characteristics. They also found more complex relationships between the risk rating and other loan characteristics. The Federal Reserve also used the STL loan risk ratings to study some of the implications of the changes proposed in the new Basel II Capital Accord. This work suggested that more closely linking capital requirements to the riskiness of individual business loans might allow banks to set aside noticeably less capital for those loans and might not substantially change the cyclical behavior of required capital levels.⁵ Federal Reserve staff also found that risk ratings on a bank's newly extended business loans help predict changes in the rating assigned to the bank by federal regulators.⁶

² See, for example, Benjamin M. Friedman and Kenneth N. Kuttner, "Economic Activity and the Short-term Credit Markets: An Analysis of Prices and Quantities," *Brookings Papers on Economic Activity*, 2: 1993; or Lamont K. Black and Richard J. Rosen (2007) "How the credit channel works: differentiating the bank lending channel and the balance sheet channel." Federal Reserve Bank of Chicago, *Working Paper Series*: WP-07-13.

³ Allen N. Berger, Anil K. Kashyap, and Joseph M. Scalise (1995) "The Transformation of the U.S. Banking Industry: What a Long, Strange Trip It's Been." *Brookings Papers on Economic Activity*, v. 0, iss. 2, pp. 55-201.

⁴ William B. English and William R. Nelson (1998), "Bank risk rating of business loans" Board of Governors of the Federal Reserve System (U.S.), *Finance and Economics Discussion Series*: 1998-51.

⁵ Seth B. Carpenter, William Whitesell, and Egon Zakrajšek (2001) "Capital requirements, business loans, and business cycles: an empirical analysis of the standardized approach in the new Basel Capital Accord." Board of Governors of the Federal Reserve System (U.S.), *Finance and Economics Discussion Series*: 2001-48.

⁶ Donald P. Morgan and Adam B. Ashcraft (2003) "Using Loan Rates to Measure and Regulate Bank Risk: Findings and an Immodest Proposal." *Journal of Financial Services Research*, v. 24, iss. 2-3, pp. 181-200.

In recent years, the Federal Reserve has developed estimates of funding costs for STL loans based on their repricing interval and comparable-maturity market rates. By adjusting for the effects of different repricing intervals, the staff has found a stronger relationship between changes in loan pricing observed in the STL and the changes observed in other sources, such as the Senior Loan Officer Opinion Survey on Bank Lending Practices (FR 2018; OMB No. 7100-0058). Moreover, as corporate bond and business loan markets have become more integrated in recent years, this work has allowed analysis of the distribution of loan spreads relative to comparable distributions for bond spreads and syndicated loan spreads.⁷

The STL provides the only information on marginal returns on business loans for all banks and a wide range of loan sizes. As a result, the STL provides valuable insights into shifts in the composition of banks' business loan portfolios and the implications of those shifts for bank profitability. For example, the results of the STL have generally been presented in the articles on commercial bank profitability published annually in the *Federal Reserve Bulletin*.

The STL is an important source of individual loan data used by those concerned with lending to small businesses, for which banks are the primary source of credit.⁸ The Small Business Administration (SBA) uses aggregate measures taken from the survey to inform national policy on bank lending to small businesses.⁹ The SBA considers STL information useful in analyzing trends in this sector and uses the information on loans by size in briefings for senior SBA officials. In addition, the SBA publishes aggregate STL data on small-business loans, as well as an analysis of these data, in various publications.¹⁰

Farm Loan Survey (FR 2028B)

This survey collects basic information that the Federal Reserve uses to monitor financial developments in the agricultural sector of the economy. For example, the data were invaluable during the period of financial stress for many farmers and farm lenders that began early in the 1980s. When that stress began to ease, the severe drought that developed in mid-1988 renewed concerns about the financial health of the farm sector. The STL provided a timely indicator of the possible effects of the drought on the terms of loans for various purposes.

The STL collects information on farm financial developments that is frequently used by the Federal Reserve in congressional testimony, meetings with legislators, and discussions with farm groups, as well as in response to information requests from the Congress, other government agencies, the media, and academics.

⁷ William F. Bassett and Egon Zakrajšek (2003) "Recent Developments in Business Lending by Commercial Banks." *Federal Reserve Bulletin*, v. 89, iss. 12, pp. 477-92.

⁸ Allen N. Berger (2006) "Potential Competitive Effects of Basel II on Banks in SME Credit Markets in the United States." *Journal of Financial Services Research*, v. 29, iss. 1, pp. 5-36.

⁹ For example, see the paper prepared for the Small Business Administration under contract no. SBA-HQ-02-Q-0024, Diana Hancock, Joe Peek, and James Wilcox (2005) "The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks." KeyPoint Consulting LLC. Emeryville, CA.

¹⁰ See, for example, "The Small Business Economy: A Report to the President." United States Government Printing Office. Washington, DC: 2007, pp. 26-28.

Data from the STL have been very useful in monitoring the ongoing adjustment of rural banks to the more volatile supply of, and demand for, loan funds of recent years. In 1978, bank regulators removed fixed ceilings on interest rates paid on certain retail deposits, which were most prevalent at rural banks, leading these small banks to compete more vigorously for deposits. Since that time the agricultural sector—the underlying source of prosperity in many small communities—has experienced large swings in farm income, asset values, and rates of resource utilization. Data from the STL on the level and distribution of loan maturities and loan rates among smaller banks have provided a useful indicator of the degree to which these additional sources of risk have been passed through to rural borrowers.

The STL collects unique information on lending terms for farm borrowers, and the availability of a historical series on farm lending frequently proves useful in addressing new questions that arise. For example, the data have been quite useful in providing a scale to measure the amount of government subsidy that is provided to farmers through governmental or quasi-governmental agencies. Legislation passed in 1987 to assist the Farm Credit System (FCS) forbade the FCS from offering unusually low rates of interest, by basing the interest rate it charged on farm loans on its average cost of funds rather than its marginal cost. Aggregate estimates from the STL data provided a useful benchmark in a General Accounting Office study of the FCS's performance in this regard (GAO-94-39, March 1994). The aggregate STL data also have been used in recent years by analysts at the Department of Agriculture to monitor compliance with the North American Free Trade Agreement by estimating the magnitude of farm subsidies arising from loans to U.S. farmers from the FCS and the Farmers' Home Administration. In addition, the Federal Reserve has used the information on farm lending terms and the risk ratings for individual loans to examine the degree to which commercial banks price the riskiness of agricultural loans. This study found that only about half of the reporters for the FR 2028B used a risk rating system, but most of the banks that did not were quite small, and so roughly four-fifths of the survey loans carried an informative risk rating. Furthermore, after controlling for the size and performance of the bank and as many nonprice terms of the loan as possible, banks consistently charged higher rates of interest for farm loans that they characterized as riskier.¹¹

Prime Rate Supplement (FR 2028S)

The prime rate remains the base rate banks use to price a significant portion of the loans covered by the STL.¹² Even for large borrowers and the largest banks, the prime rate, an administered rate, is a pricing option frequently available along with market-related rates.

The FR 2028S is completed by banks that file either the FR 2028A (loans to businesses) or the FR 2028B (loans to farmers) or both. The prime rate is by far the most common base rate used to price variable rate business and farm loans at small and medium-sized banks. The FR 2028S imposes little burden, and the information it provides is useful in interpreting movements in rates charged on business and farm loans, especially for small loans and for loans at smaller banks. The

¹¹ Nick Walraven and Peter Barry (2004) "Bank Risk Ratings and the Pricing of Agricultural Loans." *Agricultural Finance Review*, Vol. 64, No. 2, pp. 107-118.

¹² The 2028S defines the prime rate to be, "[T]he administered rate used [by the bank] for pricing business and other credit, which [is adjusted] from time to time in response to changes in market conditions. [The] institution may set this rate internally or may adopt as its own a published rate."

FR 2028S data are also collected from the fifty U.S. branches and agencies of foreign banks on the business loan survey. They provide valuable information about variations in the prime-lending rate across banks, which can be considerable. The STL is the only national source of data on the prime rate at banks of all sizes.

Description of Information Collection

The STL comprises three reporting forms. The FR 2028A collects loan information from a stratified sample of 398 banking institutions on the face amount, the rate of interest (including the base pricing rate), the frequency of compounding, the date on which the loan rate can be recalculated (if any), the maturity date (if any), the commitment status, whether the loan is secured, and the risk rating. The FR 2028B collects much the same information from a stratified sample of 250 banks and collects additional data items on federal insurance status, security status, participation status and primary purpose. The FR 2028S collects from both FR 2028A and FR 2028B respondents their prime lending rate on each day of the survey week.¹³ The Federal Reserve proposes to keep the size of the FR 2028 panels at their current levels. The data are collected for the first full business week of the mid-month of each quarter (February, May, August, and November). The Federal Reserve has found the current size of the panels to be sufficient for their analysis of changes in conditions in these diverse loan markets and the quarterly frequency to be an adequate balance between the timeliness of the data and reporting burden.

The loan risk ratings added in 1997 have proven very valuable to the survey data users to inform monetary policy and conduct economic research. In the STL, banks report the risk rating of the loan by mapping their internal loan risk ratings to a scale defined by the Federal Reserve, which takes on values between 1 and 5, with the rating of 1 indicating lowest risk and the rating of 5 indicating highest risk. Because of the importance of the risk ratings, the Federal Reserve recommends that the Reserve Banks periodically verify that each respondent bank is correctly mapping its most current risk rating system to the risk categories defined in the STL. This verification would occur no more frequently than once per year unless an anomaly in the data was found during the normal course of editing the data.

Proposed Revisions to the FR 2028A

The Federal Reserve proposes to increase the minimum loan size reported on the FR 2028A from \$3,000 to \$7,500. The change will result in a reduction in the reporting burden for survey respondents without materially compromising the survey's usefulness in conducting monetary policy or research. The minimum loan size on the FR 2028B will remain \$3,000, as the mean and median loan sizes reported on that survey are significantly smaller than those reported on the business loan survey.

Based on data for 2007, about 4,000 loans reported on the FR 2028A each quarter, or about 11 percent of all loans, are in an amount of less than \$7,500 (Table 1). Those loans account for only a tiny share—0.1 percent—of the total dollar volume of loan originations in a typical survey. Moreover, the Federal Reserve publishes only aggregated STL data for various categories of loans.

¹³ Some banks report for only part of the survey week (and some report for only some of their offices).

One of the categories is the loan size, where the smallest subcategory contains loans in the amount between \$3,000 and \$99,999. For each category, the E.2 release contains data on the weighted average loan characteristics—such as loan rates, risk rating, and days to maturity—with the weights based importantly on loan size; given the distribution of loan sizes in a typical survey, loans smaller than \$7,500 receive little weight and have very little impact on the average values even in the smallest size subcategory. In addition, the proposed minimum loan size represents an adjustment to the original \$1,000 minimum size that is consistent with the growth of commercial and industrial loans held by banks since the inception of the survey in 1977. Therefore, the costs incurred by financial institutions and the Federal Reserve System in collecting data on loans for less than \$7,500 likely exceeds the benefits derived from collecting them.

Table 1
Fraction of Loans with Amounts Less than \$7,500

Year	Fraction of total loans		Fraction of loans less than \$100,000	
	Number of loans	Weighted amount of loans*	Number of loans	Weighted amount of loans*
2006	0.128	.001	0.192	0.035
2007	0.111	.001	0.167	0.032

* Dollar amounts are weighted by the fraction of the week that the bank reports, the fraction of branches of the bank that it reports, and the portion of the commercial bank universe that the reporting bank represents.

The Federal Reserve also proposes to clarify the instructions about excluding loans secured by real estate, even if for commercial and industrial purposes, while making sure to include construction and land development loans that are not secured by real estate.

Time Schedule for Information Collection

The STL is filed every quarter. Reserve Banks collect the data from respondents in their respective districts, edit the data, and transmit them to the Board for central processing. Data are transmitted from the Reserve Banks to the Board by the fourth Thursday following the Monday as-of date. The final report and statistical release tables are completed at the Board about six weeks after the end of the survey period.

The Federal Reserve publishes aggregated data for business loans quarterly in a widely distributed statistical release, *Survey of Terms of Business Lending* (E.2); the tables contained in it summarize data from the FR 2028A and FR 2028S. These data also appear in the statistical supplement to the *Federal Reserve Bulletin* in a table titled “Terms of Lending at Commercial Banks” (4.23). Aggregate information on farm loans from the FR 2028B is published in the Board’s quarterly statistical release, *Agricultural Finance Databook* (E.15). The survey results are also included in statistical compilations published both within and outside the Federal Reserve.

Legal Status

The Board's Legal Division has determined that this survey is authorized by section 11(a)(2) of the Federal Reserve Act [12 U.S.C. § 248(a)(2)] and is voluntary. Individual responses 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 the Small Business Administration about the proposed increase in the minimum loan size on the FR 2028A. The Small Business Administration had no objection to the change. On August 4, 2008, the Federal Reserve published a notice in the *Federal Register* (73 FR 45222) requesting public comment for 60 days on the extension, with revision, for the FR 2028. The comment period for this notice expired on October 3, 2008. The Federal Reserve did not receive any comments on the proposed revisions. On October 15, 2008, the Federal Reserve published a final notice in the *Federal Register* (73 FR 61128) for the FR 2028.

Estimate of Respondent Burden

As presented in the table below, the current annual reporting burden for the STL reports is estimated to be 7,317 hours. The estimated average hours per response for the FR 2028A would decrease from 3.7 hours to 3.4 hours due to the proposal to increase the minimum loan size reported. Therefore, the proposed annual burden would be 6,840, a decrease of 477 hours. The proposed total burden represents less than 1 percent of the total Federal Reserve System burden.

	<i>Number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Current				
FR 2028A	398	4	3.7	5,890
FR 2028B	250	4	1.2	1,200
FR 2028S	567	4	0.1	<u>227</u>
<i>Total</i>				<u>7,317</u>
Proposed				
FR 2028A	398	4	3.4	5,413
FR 2028B	250	4	1.2	1,200
FR 2028S	567	4	0.1	<u>227</u>
<i>Total</i>				<u>6,840</u>
<i>Change</i>				(477)

The total cost to the public is estimated to decrease from the current level of \$451,093 to \$421,686 for the revised STL survey.¹⁴

Sensitive Questions

These reports contain no questions of a sensitive nature, as defined by OMB guidelines.

Estimate of Cost to the Federal Reserve System

The proposed cost to the Federal Reserve System for collecting and processing the FR 2028 is estimated to be \$310,000 per year, a decrease of \$900 from the current cost of \$310,900. The one-time cost to implement the revised reports is estimated to be \$10,300.

¹⁴ Total cost to the public was estimated using the following formula. Percent of staff time, multiplied by annual burden hours, multiplied by hourly rate: 30% Clerical @ \$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, Occupational Employment and Wages, news release.