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 voluntary Semiannual Report of Derivatives Activity (FR 2436; OMB 7100-0286). This report collects derivatives market statistics from the eight largest U.S. dealers of over-the-counter (OTC) derivatives. Data are collected on the notional amounts and gross fair values of the volumes outstanding of broad categories of foreign exchange, interest rate, equity, commodity-linked, and credit default swap OTC derivatives contracts across a range of underlying currencies, interest rates, and equity markets.

This collection of information complements the triennial Central Bank 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 aggregates of national data.

The Federal Reserve proposes to revise the FR 2436 by adding central counterparties to the counterparty breakdowns provided for foreign exchange, interest rate, and equity derivatives in Tables 1A, 1B, 1C, 2A, 2B, 2C, 3A, 3B, 3C, 5, and 6, which collect data on, respectively, foreign exchange contracts, interest rate contracts, equity contracts, maturity of contracts, and total counterparty credit exposures. (Central counterparties are already broken out for credit default swaps, reported in Table 4A, 4B, 4C, 4D, 4F, and 4G.) Following the global financial crisis, financial regulators have encouraged greater use of central counterparties for derivatives contracts, and this change would allow the Federal Reserve to better track such use. In addition, the BIS is adding central counterparties to the counterparty breakdowns in its international derivatives data collection, and this change will allow the United States to align with BIS reporting guidelines. The Federal Reserve also proposes to amend the definition of central counterparties in the FR 2436 instructions to align more closely with the definition used in capital regulations. In addition, the Federal Reserve proposes to correct a row heading in Table 5, to update the list of reporting dealers in Annex II, to drop Annex I (which is a copy of the report form) from the instructions and renumber the remaining annexes, and to make minor corrections to instructions.[1] The current estimated annual burden for this report is 3,392 hours. The annual burden for the revised report is estimated to be 3,776 hours, an increase of 384 hours. Draft copies of the proposed reporting form and instructions are attached.

Background and Justification

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

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[1] Report form instructions do not typically include the report form itself.

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 fair 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 fair values of *all* market participants (not just of reporters), the gross positive fair value of nonreporting firms can be captured by measuring the negative fair value of reporting firms' contracts with nonreporting firms. Thus, market size statistics based on gross fair value can be constructed while maintaining a limited reporting population.

During 2012 and 2013, the Federal Reserve revised the FR 2436 by collecting additional data on credit default swaps (CDS) counterparties in Table 4E. Following the broad expansion of CDS data collected on the report and implemented during 2010 and 2011, it was determined that the data on location of CDS counterparties needed further refinement in order to align the data collection with current BIS standards and to improve the interpretive power of the CDS counterparty data.

Description of Information Collection

The panel of derivatives dealers provides data on outstanding positions (notional, gross positive and gross negative fair 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 credit exposures and liabilities arising from all outstanding CDS contracts, as well as from the entire portfolio.

Notional amounts outstanding (Tables 1A, 2A, 3A, 4A, 4B, 4C, 4D, 4E, 4H, 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 fair values (Tables 1B, 1C, 2B, 2C, 3B, 3C, 4F, and 6). Respondents report as fair 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 fair value based on the quoted market price of a similar contract or on valuation techniques such as discounted cash flow.

Credit exposures and liabilities from credit default swap contracts (Table 4G). Table 4G collects net positive and net negative fair values of all CDS, taking into account any CDS contracts with legally enforceable bilateral netting agreements. Net positive and net negative fair values measure, respectively, the total credit exposure and liability to counterparties that arise from only CDS contracts.

Credit exposures and liabilities (Table 6). In addition to gross fair values, Table 6 collects net fair values, which take into account any legally enforceable bilateral netting agreements. Net fair values capture the credit exposures and liabilities arising from OTC derivatives contracts (excluding commodity contracts), i.e., the amounts that reporting dealers would owe to and 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 fair 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, in the market risk category of credit risk, considerable detail on credit derivatives is collected on one type of product, CDS, which are broken out into single-name and multiple-name instruments, whereas for synthetic tranched structured finance instruments, only protection bought and sold is collected.

Counterparty types: Reporting dealers, other financial institutions, and nonfinancial institutions. For CDS, other financial institutions are further broken out into (1) banks and securities firms, (2) insurance firms, (3) special purpose vehicles, (4) hedge funds, and (5) other. Additionally, information about the location of the counterparty is collected for CDS. This finer disaggregation of counterparty types and the location of the counterparty gives central banks and other data users a clearer picture of how CDS 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 CDS are reported by characteristics—the sector and credit rating—of the reference entity or entities (in the case of multi-name instruments). Data on the sector of the reference entity are broken into sovereigns, financial firms, nonfinancial firms, asset-backed securities, or multiple sectors, which has a sub-category for index products. Data on the credit rating of reference entity or entities are broken into upper investment grade (AAA or AA), lower investment grade (A or BBB), sub-investment grade (BB and below), or not rated.

Protection bought and sold: For CDS, and synthetic tranched structured finance instruments, 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 these products are used to shift credit risk among market participants.

Proposed Revisions

The Federal Reserve proposes to add central counterparties as an additional counterparty type for foreign exchange contracts in Tables 1A, 1B, and 1C, for interest rate contracts in Tables 2A, 2B, and 2C, for equity contracts in Tables 3A, 3B, and 3C, for maturity of contracts in Table 5, and for credit exposures and liabilities in Table 6. The Federal Reserve's interest in obtaining more detail on counterparty type arises because of the role that counterparty credit risk played in the recent global financial crisis. Central counterparties are of particular interest because after the crisis, financial regulators have encouraged greater use of central counterparties for derivatives contracts. The proposed revision would allow the Federal Reserve to better track the use of central counterparties for all types of derivatives contracts. Currently, central counterparties are broken out for only CDS contracts (Table 4A, 4B, 4C, 4D, 4F, and 4G). In addition, the BIS is expanding its data collection on the global OTC derivatives market to include a breakdown of contracts with central counterparties, and the proposed revision would allow the United States to align its data collection with BIS reporting guidelines.

The Federal Reserve also proposes to amend the definition of central counterparties in the FR 2436 instructions to align more closely with the definition used in capital regulations.[2] Currently, the FR 2436 instructions give a more general definition of central counterparties and then list central counterparties in Annex V. Since the last revision of the FR 2436, many more central counterparties have been established. As a result of these changes, Annex V would be removed.

The Federal Reserve proposes to correct a row heading in Table 5, to update the list of reporting dealers in Annex II, to drop Annex I (a copy of the report form) from the instructions and renumber the remaining annexes, and to make minor corrections to instructions.

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[2] See Section 217.2 of 12 CFR Chapter II, Subchapter A.

Reporting Panel

The U.S. 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, eight U.S. institutions participate in the reporting panel. This panel covers 99 percent of all foreign exchange derivatives contracts at U.S.-headquartered bank holding companies and 99 percent of all OTC derivatives contracts at U.S.-headquartered bank holding companies.

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 sends the aggregated data to the BIS and sends reporter-level and aggregated data to the Board. The Board 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.

Legal Status

The Federal Reserve’s has determined that this report is authorized under sections 2A and 12A of the Federal Reserve Act (FRA). Section 2A of the FRA requires the Federal Reserve Board and the Federal Open Market Committee (FOMC) to maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates (12 U.S.C. § 225a) and section 12A of the FRA requires the FOMC to implement regulations relating to the open market operations conducted by Federal Reserve Banks with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country (12 U.S.C. § 263). Because Federal Reserve System uses the information obtained from the FR 2436 to fulfill these obligations, these statutory provisions provide the legal authorization for the collection of information on the FR 2436.

Additionally, because all survey respondents are currently registered as bank holding companies, this survey is also authorized under section 5(c) of the Bank Holding Company Act (12 U.S.C. § 1844(c)).

The FR 2436 is voluntary. Because the release of this information would cause substantial harm to the competitive position of the entity from whom the information was obtained, the information collected on the FR 2436 may be granted confidential treatment under exemption (b)(4) of the Freedom of Information Act (5 U.S.C. § 552(b)(4)), which protects from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential."

Consultation Outside the Agency

Given the relatively small changes to the report forms during the current renewal of this information collection and the fact that respondents already identify CDS contracts with central counterparties, the Federal Reserve did not consult with other G-10 central banks or reporting institutions on the details of the data to be collected, or about the feasibility and reporting burden of the proposed additional data items.

On December 1, 2015, the Federal Reserve published a notice in the *Federal Register* (80 FR 75102) requesting public comment for 60 days on the extension, with revision, of the FR 2436. The comment period for this notice expired on February 1, 2016. The Federal Reserve did not receive any comments. On February 19, 2016, the Federal Reserve published a final notice in the *Federal Register* (81 FR 8491)

Estimate of Respondent Burden

The current annual reporting burden for this information collection is estimated to be 3,392 hours, as shown in the table below. The proposed additional data items increase the estimated average hours per response from 212 hours to 236 hours. The total burden represents less than 1 percent of total Federal Reserve paperwork burden for all reports.

FR 2436	*Number of respondents*[3]	*Annual frequency*	*Estimated average hours per response*	*Estimated annual burden hours*
Current	8	2	212	3,392
Proposed	8	2	236	3,776
Change				384

The total cost to the public is estimated to be $175,536 and would increase to $195,408.[4]

[3] Of the 8 respondents, none are considered small entities as defined by the Small Business Administration (i.e., entities with less than $550 million in total assets) www.sba.gov/content/small-business-size-standards.
[4] Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rates (30% Office & Administrative Support at $17, 45% Financial Managers at $63, 15% Lawyers at $64, and 10% Chief Executives at $87). Hourly rates for each occupational group are the (rounded) mean hourly wages from the Bureau of Labor and Statistics (BLS), *Occupational Employment and Wages May 2014*, published March 25, 2015 www.bls.gov/news.release/ocwage.t01.htm. Occupations are defined using the BLS Occupational Classification System, www.bls.gov/soc/.

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.