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THE CLEARING HOUSE
Advancing Payment Solutions Worldwide

September 23, 2004

Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Attention: Ms. Jennifer J. Johnson
Secretary

Re: Request for Comment on Proposed Revisions to Reports FR 2436 and FR Y-12

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks[1], appreciates the opportunity to comment on the proposed revisions to Reports FR 2436 "Semiannual Report of Derivatives Activity" and FR Y-12 "Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies" by the Board of Governors of the Federal Reserve System ("The Board"). Our comments on these proposals are set forth below.

Semiannual Report of Derivatives Activity (FR 2436)

The Clearing House's comments regarding the FR 2436 specifically address the proposed report form changes, mainly the inclusion of credit derivatives. However, before discussing our specific comments, The Clearing House believes it is essential to make a general comment about the Board's estimate of respondents' reporting burden.

Estimate of Respondents' Reporting Burden

The Board has estimated average hours per response currently to be 100, and following the proposed changes to be 150, or 300 annually. The Clearing House member banks

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[1] The members of The Clearing House are Bank of America National Association, The Bank of New York, Citibank, N.A., Deutsche Bank Trust Company Americas, HSBC Bank USA, National Association, JPMorgan Chase Bank, LaSalle Bank National Association, U.S. Bank National Association, Wachovia Bank, National Association, and Wells Fargo Bank, National Association.

believe that the burden hours are significantly understated. Some of our members have estimated their reporting burden to be currently as high as 3,500 hours annually, and with the proposed changes, to increase to as much as 4,000 hours annually.

Possible Acceleration of the Filing Date of FR 2436 in the Future

The "Supporting Statement for Semiannual Report of Derivatives Activity" states that the G-10 central banks would like to change the reporting due date to thirty days at some time in the future, since when they approved this information collection, "they anticipated that respondents would fully automate the preparation of the FR 2436." Since the voluntary implementation of the FR 2436 in 1998, banks have not been able to fully automate the data captured on the FR 2436, and its preparation remains a highly manual process. One of the main reasons why the data is not systematically available is that the data detail as reported in the FR 2436 is generally not used by our member banks' management and consequently, investment in the automation of this information is a lower priority. Examples of this detail breakout is the distinction among reporting dealer, non-reporting dealer and other non-financial entities for notional value of OTC contracts and gross positive and gross negative fair market values. In addition, given the recent acceleration of other regulatory filings such as the Call Report and FR Y-9C, the burden on our member banks already has been increased. The voluntary FR 2436 statistical report would further tax our member banks' resources. Therefore, we recommend that the due date of the FR 2436 be changed to 90 days after the semi-annual reporting period so that resources used for the completion of the FR 2436 do not need to compete with those used for the other 45-day and 60-day supervisory reports (e.g., FR Y-9LP, FFIEC 009, FFIEC 030, FR Y-8, FR Y-12, FR Y-11, FR 2314, etc.).

Collection of Credit Derivative Data

The Clearing House strongly opposes the collection of credit derivative data on separate schedules on the FR 2436. The rationale given by the Board for the extensive data collection on credit derivatives is that it will provide a clearer picture of the nature and amount of credit risk that is transferred and that the credit derivatives market has had very rapid growth. We do not believe that the reasons provided justify the costs to the industry or that the data collected will assist banks in better monitoring their risks in credit derivatives. In addition, credit derivatives are only a small portion of a bank's off-balance sheet derivative book and credit risk exposure. Furthermore, the quarterly FR Y-9C Schedules HC-L and HC-R already capture credit derivative information on guarantor and beneficiary notional values and counterparty ratings (investment versus non-investment grade), as well as gross positive and negative fair values. Therefore, The Clearing House recommends that credit derivative data be included on the FR 2436 in Tables 3A-3C, "Equity and Commodity-Linked Contracts," to obtain the regional detail. A memo line also could be added to each table to capture the amount of credit derivatives. This disclosure would have a more reasonable cost/benefit relationship as compared to the current proposal.

If the Board, after consideration of our concerns, continues to believe that collection of credit derivative data on separate schedules on the FR 2436 is essential, we suggest that the Board consider limiting the number of schedules and information requested. To accomplish that objective, we recommend restricting the counterparty data to reporting dealers and other financial and non-financial institutions, which is consistent with the other schedules on the FR 2436. The sub-categories under “other financial” are difficult to determine, would have to be compiled manually, and are of little use in determining risk characteristics. In addition, a bank’s exposure to outstanding credit derivative contracts may be determined by the net fair value of the portfolio, since they are marked-to-market. Credit ratings vary widely by rating agencies and many times are considered lagging indicators of credit risk. Moreover, the majority of a bank’s exposure under credit derivatives is limited to investment grade counterparties. As such, a great deal of burden hours would be consumed in determining the referenced obligor rating of all credit derivative contracts to identify a small percentage of non-investment grade obligors. The Clearing House members do not believe that the effort to comply with this requirement is cost beneficial for the immaterial number of credit derivative contracts that have referenced non-investment grade obligors. Furthermore, a bank’s credit risk on a credit derivative contract is to the counterparty, usually another bank, and not to the underlying or referenced obligor. Since the proposal will capture the rating of the referenced obligor, it will not be indicative of the credit risk a bank is assuming or transferring out.

The proposed schedule 4B will capture credit derivatives by sector of the referenced obligor. The rationale given for capturing this data is that it will provide a clearer picture of the credit risk being transferred. As stated above, we believe that the credit risk on a credit derivative contract is to the counterparty, not to the referenced obligor. Again, the process required to capture this data is very manually intensive since systems do not capture this data. Thus, The Clearing House believes that the burden hours needed to capture the requested sector data far outweigh the benefit this data will provide.

Another aspect that should be considered is that many credit derivative transactions are entered into as a hedge on a bank’s loans and securities portfolios. Since the FR 2436 is only capturing data on credit derivative contracts and not on the loans or securities that are being hedged, the information reported may be misleading.

<u>Opt-Out of Filing the Report</u>

Since the FR 2436 is a voluntary and statistical report, not necessary for supervisory purposes, The Clearing House requests that the Board consider allowing banks a procedure to opt-out of filing the report or opt-out of filing individual schedules.

Effective Date

If the Board nevertheless determines to proceed with the proposed revisions to the FR 2436 in their current form, The Clearing House urges the Board to delay the implementation date of these revisions for a minimum of one year. This additional time is necessary for banks to implement changes to their processes and other resources that would be required to fulfill the new filing requirements.

Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12)

Schedule A—Addition of Memorandum Item 4, "Investments managed for others"

The revised instructions for this proposed item do not adequately define nonfinancial equity investments managed for others. While the revised instructions indicate that "these investments are not owned by the Bank Holding Company ("BHC") and are not consolidated in the BHC's financial statements", they do not indicate whether any such investments managed through a BHC's trust, brokerage or mutual fund businesses are to be included. Collection of this data would be burdensome as nonfinancial equity investments is not typically a standard reporting category for such business lines. Additionally, we feel this memorandum item falls outside the scope of the FR Y-12 as indicated in the "Supporting Statement for the Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies": "The FR Y-12 collects information on the types of investments made by BHCs and their subsidiaries in nonfinancial companies" and in the description of Schedule A: "The memoranda items collect information on the number of companies in which investments are made for the entire portfolio, investments made under the merchant banking authority, and the impact on net income." Therefore, we oppose the addition of Memorandum Item 4 to Schedule A.

Addition of Schedule D—Nonfinancial Investment Transactions During the Reporting Period

The addition of this schedule would require the tracking of significantly more data and would be burdensome to BHCs. The Clearing House member banks have indicated that this data currently is not readily available and providing such detail would require the implementation of new tracking systems to capture the detail as proposed. It appears currently that there is no intended use for this data other than to provide trend data for possible industry studies at some future date. We strongly oppose the addition of Schedule D as there is no specific intended use for the data to be collected, and we do not believe that the reasons provided justify the costs to the industry.

Revised Instructions for Acquisition Costs

The definition of acquisition costs as presented in the revised instructions continue to be unclear and in conflict with guidance given to The Clearing House member banks. The revised instructions state "adjustments for impairment write-downs…and fair value adjustments should not be included." The instructions also state "for nonfinancial equity investments that are accounted for under the equity method of accounting, the carrying value is the acquisition cost adjusted for pro-rata share of earnings/losses and decreased by cash dividends or similar distributions." Some of The Clearing House member banks have been directed by their Federal Reserve Bank examiners to include adjustments for impairment write-downs, including partial write-downs, as adjustments to acquisition costs. Therefore, the instructions should be clarified with regard to the inclusion in acquisition costs of the equity pick-up for investments accounted for under the equity method.

Effective Date

If the Board nevertheless determines to proceed with the proposed revisions to the FR Y-12 in their current form, The Clearing House urges the Board to delay the implementation date of these revisions for a minimum of two quarters. This additional time is necessary for banks to implement changes to their processes and other resources that would be required to fulfill the new filing requirements.

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Thank you for considering the concerns expressed in this letter. If you have any questions, please contact Norman R. Nelson at (212) 612-9205.

Sincerely yours,

cc: Mr. Kenneth P. Lamar
Federal Reserve Bank of New York