

**Supporting Statement for the  
Consolidated Bank Holding Company Report of  
Equity Investments in Nonfinancial Companies  
(FR Y-12; 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, with revisions, the mandatory Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12; OMB No. 7100-0300). This quarterly report was implemented as of September 30, 2001, in response to the Gramm-Leach-Bliley Act (GLB Act) of 1999, which broadened the scope of permissible investments in nonfinancial companies.

The Federal Reserve proposes to revise the FR Y-12 reporting form and instructions to enhance the Federal Reserve's ability to monitor and supervise the private equity merchant banking (PEMB) activity across all BHCs for purposes of safety and soundness. This report collects information from certain domestic BHCs on their equity investments in nonfinancial companies on three schedules: Type of Investments, Type of Security, and Type of Entity within the Banking Organization. The proposed revisions to the FR Y-12 include modifying the reporting threshold to reduce regulatory burden, adding a memorandum item to Schedule A to collect data on investments managed for others, adding a memorandum item to Schedule B to identify whether the BHC holds any warrants received in connection with equity investment activity, simplifying Schedule C by eliminating three columns used to collect data on direct investments in public entities, direct investments in nonpublic entities, and all indirect investments, and adding Schedule D "Nonfinancial Investment Transactions During the Reporting Period" to collect information on all PEMB activity of the BHC on cumulative basis. The total current annual reporting burden is estimated to be 2,336 hours. The proposed reporting burden is estimated to be 1,696 hours, a decrease of 640 hours. The Federal Reserve proposes to defer implementation of the revised FR Y-12 until March 31, 2005, to coincide with the implementation of proposed revisions to the FR Y-9C and FR Y-9SP reports (OMB No. 7100-0128).

**Background and Justification**

Bank holding company investments in nonfinancial companies increased significantly during the late 1990s. These investments contributed significantly to earnings and capital at 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 permits financial holding companies (FHCs) to make investments in any amount, in any type of nonfinancial company as part of a securities underwriting, merchant banking or investment banking activity. The investments permissible under the GLB Act's merchant banking authority are substantially broader in scope than the investment activities otherwise permissible for BHCs. Thus, these investments present the potential for additional volatility and risk in banking organizations' portfolios.

The FR Y-12 data serves as an important risk-monitoring device for institutions active in this business line by allowing supervisory staff to monitor an institution's activity between

review dates. They also serve as an “early warning” mechanism to identify institutions whose activities in this area are growing rapidly and therefore, warrant special supervisory attention.

On January 31, 2001, the Federal Reserve and U.S. Department of Treasury (the agencies) published in the *Federal Register* a final rulemaking on merchant banking investments made by FHCs (66 FR 8466). In Section 225.175 of this final rulemaking, the agencies stated that reporting forms to fulfill the quarterly and annual reporting requirements would be published separately. The FR Y-12 fulfills the quarterly reporting requirements and, upon implementation, the “Annual Report of Merchant Banking Investments Held for an Extended Period” (FR Y-12A) would fulfill the annual reporting requirements. Regulation Y implements a holding period restriction by permitting a FHC to own or control a merchant banking investment for no longer than ten years. Merchant banking investments made in, or held through, a private equity fund, however, may be held for the duration of the fund, up to a maximum of fifteen years. A FHC must obtain the Board’s approval to own or control a merchant banking investment beyond these time periods<sup>1</sup>. The FR Y-12A will be addressed in a separate proposal in the near future.

### **Description of Information Collection**

The FR Y-12 collects information on the types of investments made by BHCs and their subsidiaries in nonfinancial companies (excluding investments held in trading accounts).

This report is filed by each top-tier domestic BHC that:

- files the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C), and
- has aggregate nonfinancial equity investments that equal or exceed the lesser of \$200 million (on an acquisition cost basis) or 5 percent of the BHC’s consolidated Tier 1 capital as of the report date, and
- has made an effective election to become a FHC *or* directly or indirectly has an Edge corporation, agreement corporation, or small business investment company subsidiary (SBICS) *or* holds equities under section 4(c)(6) or 4(c)(7) of the BHC Act.

This report is *also* filed by each top-tier domestic BHC that:

- files the Company Only Financial Statements for Small Bank Holding Companies (FR Y-9SP), and
- has aggregate nonfinancial equity investments that equal or exceed (on an acquisition cost basis) 5 percent of the BHC’s total capital as of the report date, and
- has made an effective election to become a FHC *or* directly or indirectly has an Edge corporation, agreement corporation, or SBICS *or* holds equities under section 4(c)(6) or 4(c)(7) of the BHC Act.

The current FR Y-12 reporting form comprises three schedules: Schedule A - Type of Investments, Schedule B - Type of Security, and Schedule C - Type of Entity within the Banking Organization. The information collected in each schedule is discussed below.

**Schedule A – Type of Investments** collects information 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, nonpublic entities, and all indirect investments. The

---

<sup>1</sup> (See 12 C.F.R. §§ 225.172(b)(4); 225.173(c))

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.

**Schedule B – Type of Security** collects information 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 memorandum item collects information on unused equity commitments.

**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 and B collect the acquisition cost and the carrying value of these investments, respectively. Columns C, D, and E break out the carrying values reported in Column B into direct investments in public entities, direct investments in nonpublic entities, and all indirect investments, respectively. The memoranda items collect information on foreign and domestic investments.

### *Proposed Revisions to the FR Y-12 Reporting Form and Instructions*

#### **Schedule A - Type of Investments**

- **Retitle** – Memorandum item 3 from “Impact on net income from items 1, 2, and 3 above” to “Pre-tax impact on net income from items 1, 2, and 3 above.” This modification would clarify the intent of the original item, as discussed in the instructions.
- **Add** – Memorandum item 4 “Investments managed for others.” This item would collect information on the extent of the BHC’s role in managing private equity investments for others. This item would be used to provide new information regarding the extent of the institution’s PEMB operation. Significant investment funds management activity could increase the inherent legal and reputational risk of the institution.

#### **Schedule B - Type of Security**

- **Add** – Memorandum item 2 “Does the BHC hold any Warrants or similar instruments received in connection with equity investment activity? (Enter “1” if yes, “0” if no).” This item would be used to identify whether the BHC holds any warrants or similar instruments received in connection with equity investment activity or similar “equity kickers” that, while typically carried at only a nominal value, may potentially increase the risk profile of the corporation.

#### **Schedule C - Type of Entity within the Banking Organization**

- **Add** – New column “(Column B) Net Unrealized Holding Gains Not Recognized As Income.” This information would identify net unrealized holding gains (or losses) that have not been recognized as income within the BHC structure through which the investments are made, as reported in Schedules A and B. The portfolio totals on Schedule A should equal portfolio totals reported on Schedule C.
- **Retitle** – Old column “(Column B) Carrying Value” as “(Column C) Carrying Value.”
- **Add** – Item 2.b “Edge and agreement corporations,” renumber “SBICs” as item 2.a, and renumber “Broker/Dealers” as item 2.c. This breakout from “All other” would provide consistency with item 1, as Edge and agreement corporations may be housed in either a depository institution or parent holding company structure.

- **Add** – Item 2.d “Private Equity subsidiaries” and renumber “All other” as item 2.e. This additional breakout would identify those BHCs that have established nonbank subsidiaries primarily devoted to the PEMB activity. The larger BHCs active in PEMB have typically established private equity subsidiaries.
- **Delete** – Current Columns C, D, and E Carrying Value for: “Direct Investments in Public Entities,” “Direct Investments in Nonpublic Entities,” and “All Indirect Investments.” These data were not significantly different than data collected in Schedule A, and Columns A and B of Schedule C.

#### **Schedule D - Nonfinancial Investment Transactions During the Reporting Period**

**Add** – This proposed schedule would collect information on all PEMB activity of the BHC, on an aggregate basis, for the reporting period. Columns A and B would 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 would collect information on the same items for all transactions involving indirect (fund) investments. These data would provide valuable insight into the scope of activity on a transaction basis and, when reviewed over time, would provide critical trend data useful for industry studies as well as BHC supervisory monitoring.

The proposed FR Y-12 instructions would be reorganized and clarified to conform with the proposed changes to the reporting form.

#### *Proposed Revisions to the FR Y-12 Respondent Reporting Threshold Criteria*

- **Modify** the reporting threshold criteria for respondents that file the FR Y-9C, by decreasing the aggregate nonfinancial equity investments threshold from \$200 million to \$100 million (on an acquisition cost basis) and increasing the consolidated Tier 1 capital threshold from 5 percent to 10 percent.
- **Modify** the reporting threshold criterion for respondents that file the FR Y-9SP, by increasing the total capital threshold from 5 percent to 10 percent.

The proposed decrease in the reporting threshold from \$200 million to \$100 million would require reporting from large complex banking organizations (LCBOs) that have a significant concentration of capital invested in this asset class, but fall below the current reporting threshold.

The proposed increase in the reporting threshold from 5 percent to 10 percent of capital would reduce burden for respondents, while continuing to screen for the smaller BHCs with a significant concentration of capital invested in this asset class.

- **Delete** – “Has the bank holding company made an effective election to become a financial holding company?” This information is readily available on the National Information Center database.
- **Modify** – Clarify the legal authority to read: “Directly or indirectly through a subsidiary or affiliate, any nonfinancial equity investments within a Small Business Investment Company (SBIC) structure, *or* under section 4(c)(6) or 4(c)(7) of the Bank Holding Company Act, *or*

pursuant to the merchant banking authority of section 4(k)(4)(H) of the Bank Holding Company Act, *or* pursuant to the investment authority granted by Regulation K.”

### **Reporting Panel**

The FR Y-12 reporting panel comprises a subset of top-tier domestic BHCs that file the FR Y-9C or the FR Y-9SP and meet the FR Y-12 reporting threshold criteria. A screening question on both FR Y-9 reports, developed from the FR Y-12 reporting threshold criteria, is used to determine whether the BHC is required to complete the FR Y-12. As mentioned above, the Federal Reserve proposes to revise the FR Y-12 reporting threshold criteria, which in turn would affect the screening question on the FR Y-9 reports. Proposed revisions to the screening question would be addressed during the regular clearance process later this year, to be implemented March 31, 2005. The Federal Reserve proposes to defer implementation of the revised FR Y-12 until March 31, 2005, to coincide with the implementation of proposed revisions to the FR Y-9 family of reports.

### **Frequency**

The Federal Reserve recommends that the quarterly (FR Y-9C) and semi-annually (FR Y-9SP) reporting frequency for the FR Y-12 remain unchanged. The current reporting frequencies provide adequate timely data to meet the analytical and supervisory needs of the Federal Reserve.

### **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.

### **Legal Status**

The Board's Legal Division has determined that Section 5(c) of the Bank Holding Company Act authorizes the Board to require data from BHCs to keep the Board informed of, among other things, their financial condition and risk management systems. Overall, the Board does not consider the data in these reports to be confidential. However, a bank holding company may request confidential treatment pursuant to sections (b)(4) and (b)(8) of the Freedom of Information Act [5 U.S.C. 552(b)(4) and (b)(8)]. 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.”

## Consultation Outside the Agency

The Federal Reserve conducted informal interviews with several LCBOs, soliciting comment on the proposed revisions to the FR Y-12. This proposal reflects, to a large extent, the content of the feedback received.

## Sensitive Questions

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

## Estimate of Respondent Burden

In 2001, when the FR Y-12 was implemented, the total annual reporting burden was initially estimated to be 14,112 hours, based on 232 respondents projected to be engaged in PEMB activities. However, subsequent economic and strategic decisions by BHCs have significantly reduced the number of respondents. As further confirmation of decreased PEMB activity, less than forty FR Y-12 submissions were received for the June and September 2003 report date. The current estimated annual reporting burden for the FR Y-12 report is 2,336 hours and would decrease by approximately 640 hours to 1,696, as shown in the table below. This change would be attributed to a small decrease in the estimated number of respondents resulting from the proposed revisions to the reporting threshold criteria. The Federal Reserve anticipates that the proposed deletion of three columns from Schedule C offset the addition of two memoranda items to Schedules A and B and the addition of Schedule D; therefore, there should be no net effect on the estimated average hours per response. The total burden for the FR Y-12 represents less than 1 percent of total Federal Reserve System annual burden.

FR Y-12	<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	34	4	16	2,176
Current FR Y-9SP filers	5	2	16	160
<i>Total</i>	39			2,336
Proposed FR Y-9C filers	25	4	16	1,600
Proposed FR Y-9SP filers	3	2	16	96
<i>Total</i>	28			1,696
Change	(11)			(640)

Based on an hourly cost of \$20, the estimated annual reporting cost to the public for the FR Y-12 would decrease from \$46,720 to \$33,920.

## **Estimate of Cost to the Federal Reserve System**

Current costs to the Federal Reserve System for collecting and processing these data is estimated to be \$37,330 per year. With the revisions the estimated costs will decrease by 1.6 percent to \$36,741 per year. The one-time cost to implement the revised report is estimated to be \$8,781.