

## SUPPORTING STATEMENT

### Recordkeeping Requirements for Qualified Financial Contracts

(OMB No. 3064-0163)

#### **INTRODUCTION**

The FDIC is requesting approval from the OMB to revise its pre-approved information collection, as more fully explained in the “Estimate of Annualized Burden” section, for recordkeeping requirements for qualified financial contracts (QFCs) held by insured depository institutions in a troubled condition. The final rule requires institutions deemed to be in a troubled condition to demonstrate the ability to produce certain position level and counterparty level information about QFCs after written notification by the institution’s appropriate Federal banking agency or the FDIC immediately at the close of the institution’s business day processing. The rule also requires the maintenance of certain additional information in electronic or written form pertaining to QFC transactions and the parties to these transactions. .

The proposed rule is consistent with the authority granted the FDIC in 2005 under the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) to set recordkeeping requirements for QFCs held in institutions determined to be in a “troubled condition.” Section 908 of BAPCPA revised the FDIA to allow the FDIC, in consultation with the Federal banking agencies, to prescribe regulations regarding QFC recordkeeping for institutions in a troubled condition. In developing the proposed rulemaking described herein, the FDIC has consulted with the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

#### **JUSTIFICATION**

##### 1. Circumstances and Need

Under the Federal Deposit Insurance Act (FDIA), QFCs have been designated for special treatment by the FDIC in the event of a failure of an insured depository institution. As codified in FDIA as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), certain timing restrictions are effectively placed on the FDIC for making decisions whether to transfer QFCs to another financial institution, repudiate the QFCs, or retain the QFCs in the receivership in the event of an insured institution’s failure. To make an informed decision about QFCs in such situations, the FDIC needs timely information pertaining to the types and amounts of QFC contracts held, the counterparties to these contracts and their affiliates, the purpose of these contracts, their maturity dates, the current value of these contracts, and whether these contracts are collateralized.

Because of the large volume of QFC information that a receiver must process in a limited timeframe, the FDIC is establishing QFC recordkeeping requirements for institutions in a “troubled condition” as that term is defined in the rule. The FDIC does not believe these

recordkeeping requirements are overly burdensome. Rather, the FDIC believes these requirements are consistent with safe and sound risk management practices for institutions that hold QFCs.

## 2. Use of Information Collected

The rule identifies 11 categories of QFC position level data and 7 categories of QFC counterparty level data that troubled institutions would be required to maintain in an electronic file format. These institutions would need to demonstrate the ability to produce these data items after written notification by the institution's appropriate Federal banking agency or the FDIC immediately at the close of the institution's business day processing. The FDIC will use any data so requested to evaluate its options with respect to QFCs for purposes of minimizing losses to the deposit insurance fund in the event of failure. Should a failure occur, the FDIC believes that timely access to such information will allow it to make more informed decisions about QFCs for purposes of meeting its fiduciary duty to protect the insurance fund.

## 3. Use of Technology to Reduce Burden

All institutions covered by the proposed rule would be required to use electronic files to maintain information pertaining to QFC positions and QFC counterparties. If requested, this information would be submitted to the FDIC in electronic format as well.

## 4. Efforts to Identify Duplication

There is no other source of detailed information on QFCs. Regulatory financial filings such as Call Reports and Thrift Financial Reports include certain aggregated information about the holdings of QFCs by insured institutions. However, this aggregated information is not sufficient to make decisions about QFCs in the event of an institution's failure since such decisions are required on a counterparty level basis.

## 5. Minimizing Burden on Small Banks

The FDIC believes the final rule will have a limited impact on small institutions deemed to be in a troubled condition. QFC transactions tend to be entered into by larger institutions engaged in more complex types of financial activities such as interest rate and price risk hedging and the trading of financial assets. Small institutions tend to have minimal exposure to QFCs as measured by regulatory financial reports. For example, of 61 institutions with supervisory ratings of 4 or 5 and less than \$165 million in assets as of March 31, 2008, only 11 had reported exposures that can be identified as QFCs on their regulatory financial reports. For these institutions, the estimated aggregate amount (measured by carrying values or notional amounts) of QFC contracts is small at less than 2.5 percent of aggregated total assets.

## 6. Consequences of Less Frequent Collection

There is no set frequency with which the information required under the final rule will be required to be submitted. Rather, the information is required to be submitted, upon request, to

the FDIC. However, more frequent requests may be necessary where the following factors are present: the institution deemed to be in a troubled conditions holds a large volume of QFCs, and the near term failure prospects of an institution are significant. In the event of failure, where QFC volumes are material, less frequent information collections could result in less informed decisions about the disposition of QFCs, which could in turn result in larger losses to the insurance fund than would otherwise be the case.

#### 7. Special Circumstances

Under the final rule, certain information pertaining to QFC positions and QFC counterparties will have to be maintained by insured institutions deemed to be in a troubled condition. These institutions will be required to demonstrate the ability to produce such information in electronic files after written notification by the institution's appropriate Federal banking agency or by the FDIC immediately at the close of the institution's business day processing. The short timeframe allowed in the proposed rule for producing the requested information is necessary given the time restrictions placed on the FDIC for making decisions about the disposition of QFCs in the event of failure.

Institution holdings of QFCs can change dramatically over a very short timeframes since QFCs often have short contractual maturities. In addition, the value of QFCs can fluctuate widely over short timeframes since these values are often tied to market-sensitive instruments such as interest rate, foreign exchange, commodities, and equity contracts. As a result, the FDIC believes it may be necessary to require relatively frequent reporting (more frequently than quarterly) of QFC information in the event it faces the prospect of a near-term failure of an institution. As noted in item 6 above, the FDIC will consider a number of factors in determining whether to require more frequent reporting of QFC information to include the perceived immediacy of near term failure prospects of an institution and the level and number of QFCs held (if known).

#### 8. Summary of Public Comments

The FDIC published the proposed rule pertaining to QFC recordkeeping requirements for a 60-day comment period. Four comments, one each from the American Bankers Association (ABA), the Clearing House Association (The Clearing House), the Independent Community Bankers of America (ICBA), and the International Swaps and Derivatives Association (ISDA), were received and were considered by the FDIC in finalizing the rule. The actual comments are posted on the FDIC's web site and can be accessed through the following link: <http://www.fdic.gov/regulations/laws/federal/2008/08comAD30.html>. A detailed summary of the comments and the FDIC's response to the comments is set forth in the final rule. Generally, however, each of the commenters raised concerns about the burden associated with a mandatory standardized reporting format for both position and counterparty-specific data and/or the proposed timeframe for compliance with the rule.

In recognition of the fact that banking organizations maintain QFC data in various formats across various databases, the final rule adopts a more flexible approach, requiring only that position-level data fields be accessible for FDIC monitoring purposes, with the suitability of a particular format to be determined through discussions between the FDIC, the institution, and the

appropriate Federal banking agency. Similarly, the final rule requires only that counter-party level data fields be maintained in an electronic file in a format acceptable to the FDIC. In addition, for both position-level and counterparty data requirements, the final rule includes an option for community banks in a troubled condition with less than 20 open QFC positions to record and maintain the data in a written format as long as the data can be updated on a daily basis. To address concerns regarding the timeframe for compliance, the FDIC extended the compliance deadline from 30 to 60 days and provides a mechanism through which institutions may, if necessary, request an extension of time to comply. This latter revision accounts for the slight increase in burden from that approved by OMB at the proposed rule stage.

9. Payment or Gift to Respondents

No payment or gift will be provided to respondents.

10. Confidentiality

Data submitted to the FDIC under this final rule will not be shared with the public. The FDIC may share any information collections under this final rule with the appropriate Federal banking agency.

11. Information of a Sensitive Nature

Most of the information described in the Appendix of the proposed rule relates to specific transactions between insured institutions and other QFC counterparties. Such information is deemed to be sensitive in nature and therefore subject to confidential treatment.

12. Estimate of Annualized Burden

The combined annual burden of the final rule is estimated to be 12,170 hours. This estimate is partially derived from the product of the estimated number institutions that would be subject to the final rule and the estimated hours per respondent necessary to meet the rule's reporting and records maintenance requirements. There are an estimated 190 institutions that will be subject to the reporting and recordkeeping requirements of the final rule. This is an increase of 40 from 150 institutions the FDIC estimated would be subject to the requirements of the rule at the proposed rule stage. Approximately 110 institutions would have been subject to the proposed rule on average over the past 10 years.

The combined reporting and record maintenance burdens related to the proposed rule are estimated at 64 hours per respondent annually. This estimate consists of two components: a reporting component and a records maintenance component. It is estimated that reports as described in Tables A and B of Appendix A will require 2 hours on average to complete. This estimate is based on a number of considerations including the relatively small number of items requested, the time necessary to complete other regulatory reports, and the volume of QFC activity evident in the existing population of institutions that would be subject to the proposed rule. The time necessary to produce such reports could be substantially more than 2 hours for larger institutions with greater QFC volumes. To obtain timely information on QFCs, the FDIC

may request the information required in Tables A and B relatively frequently. Assuming 12 such reports will be required within a given year brings the reporting component of the estimate to 24 hours per respondent. It is further estimated that institutions subject to these requirements will spend, on average, an estimated 10 hours per quarter, or 40 hours annually updating and maintaining the records and information required by part B of Appendix A. Again, larger institutions with greater QFC volumes would likely spend considerably more time updating and maintaining records pertaining to QFC activities. Combining the records maintenance and reporting component estimates results in an estimated annual burden of 64 hours per respondent.

In addition, the final rule provides for the submission of an application for an extension of time to comply with the rule's recordkeeping and records maintenance requirements for institutions that elect to file such applications. The FDIC estimates that approximately 20 institutions will avail themselves of this option and that the preparation of the letter application will take approximately 30 minutes per respondent.

#### Estimated Burden

Recordkeeping/records maintenance – 190 respondents x 64 hours = 12,160

Application for extension of time – 20 respondents x 30 minutes = 10 hours

Total Burden – 12,170 hours

#### 13. Estimate of Total Annual Cost Burden

For some institutions, there may be certain additional costs (excluding costs included in item 12 above) associated with implementing the proposed rule relating to developing and maintaining data systems and electronic information files. It is difficult to develop estimates of capital and start-up costs since many institutions' data systems may already have the capabilities described in the proposed reporting and recordkeeping requirements. The FDIC will evaluate any comments received pertaining to burdens of the proposed rule and modify its burden estimates as necessary prior to implementing a final rule.

#### 14. Estimate of Total Annual Cost to the Federal Government

The FDIC does not expect to incur material incremental costs in connection with the collection of information requested from institutions as a result of this proposed rule.

#### 15. Reason for Change in Burden

This is a new information collection.

#### 16. Publication

The FDIC does not intend to make any information required under this proposed rule available to the public since this information is confidential and pertains to specific transactions between insured institutions and QFC counterparties.

17. Display of Expiration Date

No exceptions are requested.

18. Exceptions to Certification

None.