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Bank Trading Revenue Is \$2.2 Billion in 2nd Quarter;
Notional Amount of Derivatives Is Record \$33 Trillion

WASHINGTON -- Banks earned \$2.2 billion in trading revenues during the second quarter, down \$1.4 billion from the unusually strong and record setting level in the first quarter, the Office of the Comptroller of the Currency (OCC) reported today in its quarterly Bank Derivatives Report.

The notional amount of bank derivatives edged 0.9 percent higher to a record \$33 trillion. The small increase marked the third consecutive quarter that volumes have remained relatively flat, increasing from \$32.6 trillion to \$33 trillion. Prior to this period, volumes had risen steadily, growing on average by approximately \$3.7 trillion per year.

Stagnant total derivatives volume obscures growth in some sectors and declines in others. Futures and forward derivatives contracts have steadily dropped from a high of \$11.6 trillion during the third quarter of 1998 to \$9.9 trillion during the most recent quarter. Options have held relatively steady at approximately \$7.5 trillion for three quarters. Since the third quarter of 1998, swaps contracts have increased steadily from \$12.4 trillion to \$15.4 trillion in the most recent quarter. Mike Brosnan, OCC Deputy Comptroller for Risk Evaluation, attributed the continuing rise in swaps contracts, which are traded over-the-counter, to "bank clients' increasing use of customized solutions for risk management problems."

At the same time, interest rate derivatives are increasingly dominating the derivatives business. The notional amount of this type of derivative contract has risen steadily since 1991 from \$3.8 trillion to a record \$25.7 trillion during the second quarter, a quarterly increase of \$655 million. The other major type of derivative contract, foreign exchange, has fallen three consecutive quarters to \$6.3 trillion in the most recent quarter, after reaching a high of \$8 trillion during the third quarter of 1998.

"All businesses are exposed to interest rate risk, so it's not unusual to see continuing increases in these contracts," Mr. Brosnan said. "With

the introduction of the Euro, however, the number of foreign currencies to which customers are exposed is declining, so it's not surprising to see a reduction in these totals."

For the third consecutive quarter, charge-offs fell with second quarter credit losses of \$25.8 million, .01 percent of the credit exposure from OTC derivative contracts. These declining credit losses reflect "a return to a more normal market environment after the extreme volatility we saw in the third quarter last year, and tighter credit standards for transactions with highly leveraged institutions," Mr. Brosnan said.

Revenue from foreign exchange derivatives has out paced interest rate derivatives revenues for seven consecutive quarters, even though their notional amount has declined while the amount of interest rate derivatives has increased. That follows a period of 10 consecutive quarters when interest rate derivatives revenue surpassed foreign exchange derivatives revenue. Mr. Brosnan attributed this change in revenue streams to "the increasing focus of the bigger players on less liquid currencies, where spreads are higher, compared to the lower margins on increasingly commoditized interest rate products."

The notional amount of short-term contracts (with remaining maturities of less than a year) decreased by \$197 billion to \$11.9 trillion. Contracts with remaining maturities of one to five years rose by \$63 billion to \$8.7 trillion, and contracts with maturities of five years or more increased by \$306 billion to \$4.3 trillion. The increase in longer maturity contracts is most pronounced in interest rate products.

"These longer term deals can represent important customer service and revenue opportunities," Mr. Brosnan said. "At the same time, they pose greater risk management challenges, because they're more difficult to hedge and the counterparty credit risks are greater."

The notional amount of credit derivatives rose by \$19 billion during the quarter to a new record of \$210 billion.

The OCC's quarterly derivatives report is based on information provided by all insured U.S. commercial banks. Other highlights of the second quarter report include:

The seven commercial banks that dominate the derivatives business accounted for 93 percent of the total notional amount

of derivatives in the commercial banking system. The top 25 banks accounted for 99 percent of this business.

Over-the-counter contracts comprised 89 percent of the notional amount for the second quarter compared to 11 percent for exchanged-traded products.

Relative to risk-based capital, total credit exposure for the top seven banks decreased to 294 percent from 309 percent in the first quarter.

During the quarter, trading revenue as a percentage of gross revenue fell at each of the top seven banks that dominate the derivatives trading business, though only one bank suffered a trading loss. For these seven banks, trading revenue accounted for 5.8 percent of their overall revenue, down from the record 9.6 percent recorded during the first quarter of 1999.

A copy of OCC Bank Derivatives Report: Second Quarter 1999 is available on the OCC web site: www.occ.treas.gov.

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The OCC charters, regulates and examines approximately 2,400 national banks and 60 federal branches and agencies of foreign banks in the United States, accounting for 58 percent of the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.

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