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Contact: Kevin Mukri
(202) 874-5770

OCC Reports Bank Trading Revenues Over $3 Billion

WASHINGTON-- Earnings from cash instruments and derivatives trading activities at U.S. commercial banks grew to $3.1 billion in the first quarter 2002, an increase of $492 million from the previous quarter. The notional amount of derivatives grew by $946 billion this quarter to $46.3 trillion.

"The rebound in bank trading revenues, from a rather lackluster fourth quarter, is consistent with the historical trend that shows that the first quarter is typically the strongest revenue quarter of the year," said Michael L. Brosnan, the Office of the Comptroller of the Currency's Deputy Comptroller for Risk Evaluation. "The resumed growth in derivatives volume also reflects the more normal operating environment compared to the fourth quarter in 2001."

In its first quarter report on bank derivatives, which was released today, the OCC noted that while the notional amount of derivatives is a reasonable reflection of business activity, it is not an amount at risk. The risk in a derivative contract is a function of a number of variables, such as whether counterparties exchange notional principal, the volatility of the currencies or interest rates used as the basis for determining contract payments, the maturity and liquidity of contracts, and the creditworthiness of the counterparties in the transactions.

The report noted that total credit exposure, which consists of both the current mark-to-market exposure as well as potential future exposure, decreased for the second consecutive quarter by $37 billion, to $445 billion. "The increase in interest rates during the first quarter helped to reduce current credit exposures. As rates dropped throughout 2001, many of the interest rate swaps done with corporate clients to hedge their debt issues had fairly large gains. The uptick in interest rates erased some of those mark-to-market gains," said Mr. Brosnan.

Banks also realized greater benefits from netting as the *gross* amount of funds owed to banks was reduced by 75.5 percent in the first quarter, compared to 73.7 percent in the fourth quarter of 2001. Total credit exposure, which includes current credit exposure as well as potential future exposure, decreased to 148% of capital from 158% of capital in the fourth quarter.

During the first quarter of 2002, banks charged-off $68 million from credit exposures associated with derivatives, down $228 million from the previous quarter. Charge-offs on derivatives

(more)

represent .015 percent of the total credit exposure from derivative contracts, compared to 0.36 percent from C&I loans.

“Typically, credit losses continue even after the economy recovers,” Mr. Brosnan said. “Nevertheless, the much lower charge-off rate on derivatives, relative to C&I loans, continues to indicate that the credit quality of derivative counterparties remains stronger than it is for bank loan portfolios.”

During the first quarter, the notional amount of interest rate contracts increased $972 billion to $39.3 trillion. Foreign exchange contracts decreased by $110 billion to $5.6 trillion. This figure excludes spot foreign exchange contracts, which increased by $61 billion to $172 billion. Equity, commodity and other contracts increased by $41 billion to $991 billion. Credit derivatives remain a small but increasing portion of the derivatives activity and increased by $43 billion to $438 billion. “Banks saw the value of credit derivatives in 2001, as they began to collect on contracts where they bought protection against borrower defaults,” said Mr. Brosnan. “It seems fairly clear that banks and their customers will continue to use these products to help control the risk of major credit losses in bad economic times.”

Overall, 85 percent of the notional amount of derivative positions was comprised of interest rate contracts with foreign exchange contracts accounting for an additional 12 percent. Equity, commodity and credit derivatives accounted for only 3 percent of the total notional amount.

The top seven commercial banks engaged in derivatives trading account for 96 percent of the total notional amount of derivatives in the commercial banking system, with more than 99 percent held by the top 25 banks.

The OCC’s first quarter report on derivatives also noted that:

- Revenues from interest rate positions increased by $206 million, to $1.5 billion, while revenues from foreign exchange contracts increased by $246 million, to $1.2 billion. Revenues from equity trading positions decreased by $18 million to $407 million. Revenues from commodity and other trading positions grew by $58 million in the first quarter to $24 million.

- Long-term contracts (maturity of five years or more) increased by $71 billion to $8.1 trillion. Notional amounts for contracts with maturities of one to five years grew by $632 billion to $13.3 trillion. Short-term (less than one year) contract notional volumes increased by $369 billion to $14.7 trillion.

- The total number of commercial banks holding derivatives increased by 10 to 379.

A copy of the *OCC Bank Derivatives Report: First Quarter 2002* is available on the OCC Web site: www.occ.treas.gov.

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The OCC charters, regulates and examines approximately 2,200 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 54 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.