NR 99-111
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December 8, 1999

Notional Amount of Derivatives Hits Record $35.7 Trillion In Third Quarter
As Derivatives Trading Revenue Remains Relatively Steady

WASHINGTON -- The notional amount of derivatives in banks jumped by $2.7 trillion -- 8.2 percent -- in the third quarter to a record $35.7 trillion, the Office of the Comptroller of the Currency reported today in its quarterly OCC Bank Derivatives Report. That is the biggest quarterly increase in derivatives activity in a year.

"The growth in derivative contract volume reflects an increase in both hedging and asset/liability management activities by bank customers during a very busy summer," said Michael L. Brosnan, OCC Deputy Comptroller for Risk Evaluation.

"Treasurers and chief financial officers had to contend with an increasingly volatile interest rate environment as well as the need to reduce their firm's vulnerability to uncertain financial market conditions during the fourth quarter of 1999 and early 2000," he added. "Most financial professionals have opted to lock in their funding requirements and associated costs in order to minimize their downside risk."

Almost all of the increase in notionals -- $2.5 trillion out of the total $2.7 trillion increase -- came in interest rate contracts, which dominate the derivatives market. Interest rate contracts with a maturity of less than a year jumped from $7.1 trillion to $8.8 trillion during the quarter, while those contracts with maturities in the one-to-five-year range rose from $8.1 trillion to $8.6 trillion. Interest rate contacts with maturities of more than five years went from $4.0 trillion to $4.7 trillion.

"OCC examiners continue to closely monitor the growth in contracts with maturities longer than five years because that is where market and credit risks are the highest," Mr. Brosnan said.

Mr. Brosnan also cited the growing importance of credit derivatives activity, which jumped $24 billion in the quarter to $234 billion. "This product has the potential to address risks associated with credit concentrations, and its growth is tied into the encouraging efforts we have recently seen to measure overall portfolio credit risk more quantitatively," he said.

Although trading revenue dropped $35 million to $2.1 billion, revenue for the last four quarters totaled $9.9 billion, the most for any consecutive four quarters. Even though the volume of interest rate derivatives dominated trading activity, foreign exchange trading revenue provided more money to banks than interest rate trading revenue, $1.1 billion to $794 million. The remaining revenue was derived from equity, commodity and other trading types of contracts.

The report also noted that:

Credit exposure from off-balance sheet derivatives contracts increased $23 billion in the third quarter, to $387 billion.

Interest rate contracts accounted for 79 percent of the notional amount of derivative contracts and foreign exchange contracts accounted for 18 percent. Equity, commodity and credit derivatives accounted for the remaining 3 percent.

Seven commercial banks dominate the derivatives market, accounting for 95 percent of the total notional amount in the commercial banking system. The top 25 banks accounted for 99 percent of this business. Altogether, 426 commercial banks were engaged in derivatives activity during the third quarter.

Over-the-counter contracts comprised 90 percent of the notional amount for the third quarter compared to 10 percent for exchange-traded products.

During the quarter, trading revenue as a percentage of gross revenue dropped to 5.7 percent, from 5.8 percent the previous quarter, at the seven top trading banks. None of the banks had a loss from trading.

Futures and forwards contracts, which had fallen for three consecutive quarters, rose in the third quarter from $9.9 trillion to $10.4 trillion. Swaps increased from $15.4 trillion to $17.4 trillion and options increased from $7.5 trillion to $7.7 trillion.

After three consecutive quarters of decline, credit losses, or charge-offs, from derivatives exposures increased from $26 million to $72 million -- which is less than .02 percent of the total derivatives credit exposure at banks trading these contracts.

Among commodities, the notional amounts for gold contracts increased dramatically from $61.4 billion to $83.4 billion. Again, most of that increase -- 70 percent, or $15.4 billion -- was in short term contracts.

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

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