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FOR IMMEDIATE RELEASE Contact: Sam Eskenazi (202) 874-5770
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OCC Reports Bank Trading Revenues Rebound To $2 Billion During Fourth Quarter

WASHINGTON -- Bank trading revenue rebounded in the final three months of 1998, as commercial banks took in nearly $2 billion following a decline in the third quarter. For the year, revenues from trading activities reached $7.9 billion compared with $8 billion in 1997, the Office of the Comptroller of the Currency reported today in its fourth quarter Bank Derivatives Report.

The OCC's report showed that much of the increase in revenue resulted from changes in interest rates affecting the values of both cash and off-balance sheet positions. Revenue from interest rate positions bounced back to $669 million in the fourth quarter, compared to a loss of $284 million in the previous three months.

Revenue increased in several other trading categories during the final three months of 1998. Commercial banks earned $64 million from commodity and other positions, up from a loss of $222 million in the previous three months, and recorded $92 million in revenue from equity positions, up from a loss of $65 million in the third quarter.

Michael L. Brosnan, the OCC's deputy comptroller for risk evaluation, said the rebound in trading and derivatives revenue resulted from the stabilization of the financial markets during the fourth quarter.

"The fourth quarter marked a return to stability, " Mr. Brosnan said. "By contrast, the previous three months were characterized by extreme volatility in both domestic and foreign markets, including the default in Russia. That volatility led to unexpected losses on trading positions at a number of banks."

Mr. Brosnan said banks should learn from the experience of the third quarter.

"Bank risk managers would be wise to adjust stress testing, risk limits and other risk control tools to recognize the reality that such extreme conditions will periodically arise," he said. "The guidance issued by the OCC in January discusses risk management practices that, if fully implemented, would help reduce banks' vulnerability to the potential recurrence of financial performances like those witnessed in late 1997 and the third quarter of 1998."

The notional volume of all derivative products increased for the 13th consecutive quarter, finishing 1998 at $32.9 trillion. Interest rate and foreign exchange contracts continued to comprise the majority of derivatives transactions.

The notional volume of credit derivatives, which the OCC began tracking in 1997, slipped to $144 billion at the end of the year, down from $162 billion in the third quarter.

Other highlights of the fourth quarter derivatives report include:

- Total credit exposure increased $1.9 billion in the fourth quarter, to $402.9 billion. Total credit exposures from the top seven banks increased to 324 percent of aggregate risk-based capital, up from 318 percent. Credit exposure would have been significantly higher without the benefit of bilateral netting agreements.

- Notwithstanding increased exposure, past due derivative contracts remained at nominal levels. For all banks, the book value of contracts past due 30 days or more aggregated only $66.8 million, or .02 percent of total credit exposure from derivatives contracts. During the Fourth quarter, banks charged off $107 million due to credit losses from off-balance sheet derivatives, or .03 percent of the total credit exposure from derivatives contracts. That is less than a twentieth of the rate of loan charge-offs.

- The notional amount of contracts with remaining maturities of less than one year increased by $245 billion during the quarter to $12.8 trillion. Contracts with remaining maturities of one to five years rose by $706 billion, to $8.2 trillion, and contracts with maturities of five or more years increased by $488 billion, to $3.6 trillion.

- Over-the-counter transactions, particularly swaps, continue to be the contract of choice for both banks and their customers. Eighty-seven percent of derivatives are in over-the-counter contracts, while 13 percent are exchanged-traded.

- Holdings of off-balance sheet derivatives continue to be concentrated in the largest banks. Seven banks account for 94 percent of the total notional volume of derivatives in the banking system, with approximately 99 percent held by the top 25 banks.

A copy of OCC Bank Derivatives Report -- Fourth Quarter 1998 may be obtained by:

. Going to the OCC's web page at http://www.occ.treas.gov;
. Ordering by phone (202) 874-5043; or
. Visiting the OCC's Public Reference Room at 250 E Street, S.W. in Washington, D.C. (9 a.m. - noon and 1 - 3 p.m., Monday - Friday).

Related Link:
Derivatives Report

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