



# NEWS RELEASE

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## OCC Reports Derivatives Volume Surpasses \$76 Trillion

WASHINGTON—Derivatives held by U. S. commercial banks increased \$5.4 trillion in the first quarter, or 7.7%, to \$76.5 trillion, the Office of the Comptroller of the Currency reported today in its quarterly *Bank Derivatives Report*.

“The interest rate decline that occurred toward the end of the first quarter offered risk managers an opportunity to lock in low rates, and a lot of them seem to have done that,” said Kathryn E. Dick, the OCC’s Deputy Comptroller for Risk Evaluation. “Our banks generally reported good client flow, and we certainly see that reflected in the very solid gain in notional volumes.”

Ms. Dick noted that derivatives volumes tend to increase as expectations for interest rates change. “The economy’s recent strength, and the associated expectations for higher interest rates, suggests further volume increases in the second quarter.”

Ms. Dick pointed out that the notional amount of derivatives outstanding, including the large first quarter growth, is a new record. While notional amounts are a reasonable reflection of business activity, they do not represent the amount at risk for commercial banks. The risk in a derivatives 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 transaction. When used properly, derivatives are a valuable risk management product to help bank institutional customers manage a broad array of different risks arising from common business activities such as securing long-term funding or protecting the value of importing or exporting commercial goods.

The OCC also reported that revenues reported by banks trading cash and derivatives instruments increased by \$1.7 billion in the first quarter, to \$3.8 billion. “We again see the familiar pattern of very strong first quarter revenue performance,” said Ms. Dick. “There’s still some noise in the revenue numbers, as tightening credit spreads continue to reduce the value of credit hedges banks have in place, but that impact has begun to diminish.”

Ms. Dick added “revenues were basically strong across all product categories.” Interest rate revenues increased by \$845 million in the first quarter to \$1.5 billion. Revenues from foreign exchange positions increased by \$213 million, to \$1.4 billion. Revenues

from equity trading positions increased by \$592 million, to \$849 million in the first quarter. Revenues from commodity and other trading positions increased by \$49 million to \$89 million.

The report also noted that total credit exposure, the sum of netted current exposure plus potential future exposure, increased 3.5% in the first quarter to a record \$779 billion. “The big rise in notionals caused a fairly sharp increase in the potential future exposure component of total credit exposure,” said Ms. Dick. Potential future exposure, which is an estimate of how high credit exposure on existing contracts can become over time, increased \$35 billion, or 6.5%, to \$573 billion. Netted current credit exposure, the other component of total credit exposure, fell \$11 billion to \$206 billion. “Netted current credit exposure fell because, even though the value of receivables on derivatives increased due to the decline in rates, there was an even larger increase in netting benefits.” The gross positive fair value of contracts, which is the mark-to-market gain on contracts with clients, increased \$135 billion. Netting benefits that reduce credit exposures increased by a \$146 billion. These two components: gross positive fair values and netting benefits, yield netted current credit exposure.

“The concentration of interest rate contracts in bank trading portfolios results in credit exposure calculations that are highly sensitive to changes in interest rates,” noted Ms. Dick. “We expect that the increase in rates across the yield curve during the second quarter will lead to a material decline in current credit exposure.”

Credit risk performance indicators confirmed the positive view of credit quality as reflected by narrowing corporate credit spreads. The report noted that only a small fraction of derivatives contracts were 30 days or more past due. For all banks, the fair value of contracts past due 30 days or more totaled only \$50 million, or .0064 percent of total credit exposure from derivative contracts. Derivatives charge-offs for the quarter were \$120 million, and represent .015 percent of total derivative exposures, well below the .17 percent for C&I loans.

During the first quarter, the notional amount of interest rate contracts increased by \$4.3 trillion, to \$66.2 trillion. Foreign exchange contracts increased by \$770 billion to \$8 trillion. This figure excludes spot foreign exchange contracts, which increased by \$427 billion, to \$700 billion. Equity, commodity and other contracts increased by \$144 billion, to \$1.2 trillion. Credit derivatives increased by \$201 billion, to \$1.2 trillion.

The derivatives business remains largely concentrated in interest rate contracts. Overall, 87 percent of the notional amount of derivatives positions was comprised of interest rate contracts, with foreign exchange accounting for an additional 10 percent. Equity, commodity and credit derivatives accounted for only three percent of the total notional amount.

The OCC first quarter derivatives report also noted that:

The number of commercial banks holding derivatives increased by 28, to 601.  
Swap contracts represent 62% of all derivative contracts.  
Netting benefits reduced gross credit exposures by 84.2%.

A copy of *OCC Bank Derivatives Report: First Quarter 2004* is available on the OCC Web site: [www.occ.treas.gov](http://www.occ.treas.gov).

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The OCC charters, regulates and examines approximately 2,000 national banks and 51 federal branches of foreign banks in the U.S., accounting for more than 56 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.

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