



NEWS RELEASE

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Administrator of National Banks

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OCC Reports Derivatives Volume Grows \$2.9 Trillion

WASHINGTON—Derivatives held by U. S. commercial banks increased \$2.9 trillion in the fourth quarter, to \$56.1 trillion, the Office of the Comptroller of the Currency reported today in its quarterly *Bank Derivatives Report*.

“Large, sophisticated commercial banks continue to serve in a financial intermediary capacity for corporate customers using derivatives to manage their financial risks,” said Kathryn E. Dick, the OCC’s Deputy Comptroller for Risk Evaluation. “When used properly, derivatives add an element of financial flexibility to the menu of financial market products used by bank institutional customers seeking to manage earnings and capital volatility.”

Ms. Dick noted that while the record notional amount of derivatives is a reasonable reflection of business activity, it does 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.

The OCC also reported that earnings attributable to the trading of cash instruments and derivatives activities decreased by \$508 million in the three-month period, to \$1.86 billion.

“While the fourth quarter certainly was not a real strong revenue quarter, it was not as weak as these numbers suggest,” Ms. Dick said. “The tightening of corporate credit spreads caused a decline in the value of credit derivative hedges banks use to manage risk in their loan portfolios. Even though this activity is hedging and not trading, regulatory reporting instructions require banks to report the value changes of their credit hedges in trading revenues. This was a major factor in comparing the revenues for the two quarters.”

The report also noted that total credit exposure, which consists of both the current mark-to-market exposure (after netting benefits), as well as potential future exposure, increased \$24 billion to \$594 billion.

“The increase in credit exposure resulted primarily from the growth in notional amounts, particularly for interest rate contracts maturing beyond five years,” said Ms. Dick.

“With rates on swap contracts having again declined in the fourth quarter, it’s not surprising to see increased credit exposure. The ongoing assessment of credit risk exposure is a fundamental part of our supervisory process in large banks.”

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 \$36 million, or .006 percent of total credit exposure from derivative contracts. Ms. Dick pointed out that derivatives charge-offs for the quarter increased \$4 million to \$74 million, while noting that the charge-off rate for derivatives is .012 percent, well below the 1.81percent for C&I loans.

“The economic uncertainty of recent quarters has caused the derivatives charge-off numbers to bounce around a bit and we expect that this may continue for the next several quarters,” Ms. Dick said.

“The derivatives business is all about credit risk,” she added. “Derivatives are simply another line of business contributing to the overall credit exposures at our large commercial banks, but to properly assess the credit risk from derivatives, you have to look beyond the raw numbers, and consider risk mitigants such as netting and collateral, in addition to the fact that derivatives counterparties on balance have stronger credit ratings than other credit businesses.”

For example, Ms. Dick pointed out that the benefits achieved from legally enforceable bilateral netting reduced current credit exposures by 81.3 percent in the fourth quarter.

During the fourth quarter, the notional amount of interest rate contracts increased by \$2.7 trillion, to \$48.3 trillion. Foreign exchange contracts increased by \$240 billion to \$6.1 trillion. This figure excludes spot foreign exchange contracts, which decreased by \$313 billion, to \$196 billion. Equity, commodity and other contracts decreased by \$66 billion, to \$1 trillion. Credit derivatives increased by \$62 billion, to \$635 billion.

Overall, 86 percent of the notional amount of derivatives positions was comprised of interest rate contracts with foreign exchange accounting for an additional 11 percent. Equity, commodity and credit derivatives accounted for only three percent of the total notional amount.

Ms. Dick said that the number of commercial banks actively engaging in derivatives remains small. “The top seven commercial banks account for almost 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 fourth quarter derivatives report also noted that:

- Revenues from interest rate positions decreased by \$476 million, to \$752 million, and revenues from foreign exchange positions increased by \$107 million, to \$1.1 billion. Revenues from equity trading positions increased by \$108 million, for a loss of \$64 million. Revenues from commodity and other trading positions decreased by \$248 million to \$30 million.
- Long-term contracts (those with maturities of five years or more) increased by \$1 trillion, to \$10.2 trillion. Contracts with remaining maturities of one to five years

grew by \$775 billion to \$15.5 trillion. Short-term contracts (those with maturities of less than one year) increased by \$667 billion to \$17.2 trillion.

- The number of commercial banks holding derivatives increased by 19, to 427.

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

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The OCC charters, regulates and examines approximately 2,100 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 55 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.