



NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

NR 2004-86

FOR IMMEDIATE RELEASE
September 24, 2004

Contact: Kevin Mukri
(202) 874-5770

OCC Reports Derivatives Volume Tops \$81 Trillion

WASHINGTON—Derivatives held by U. S. commercial banks increased \$4.5 trillion in the second quarter, to \$81 trillion, the Office of the Comptroller of the Currency reported today in its quarterly *Bank Derivatives Report*.

Kathryn Dick, the OCC's Deputy Comptroller for Risk Evaluation, pointed out that the notional amount of derivatives outstanding is a new record. Ms. Dick noted that, "notional volumes are a useful indicator of business activity. Periods of rate uncertainty, such as what we saw in the second quarter, tend to result in higher notional amounts because bank customers will often use financial derivative contracts to manage risk exposures. At the same time," she cautioned, "notional volumes tell us little about risk, since notional amounts are seldom exchanged in bank derivative contracts." 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 imported or exported commercial goods.

The OCC also indicated that revenues reported by banks trading cash and derivatives instruments decreased by \$1.2 billion in the second quarter, to \$2.6 billion. "Once again, we see the typical fall off in revenues during the second quarter, and this year, the decline appears particularly pronounced because the first quarter revenue performance was exceptionally strong. In particular, it was not a good quarter for revenues from interest rate trading, some of which may be related to rebalancing portfolios and other risk management adjustments." Interest rate revenues decreased by \$1.4 billion in the second quarter to \$124 million. Revenues from foreign exchange positions increased by \$199 million, to \$1.6 billion. Revenues from equity trading positions decreased by \$352 million, to \$497 million. Revenues from commodity and other trading positions increased by \$316 million, to \$405 million. "While these are large numbers," cautioned Ms. Dick, "trading revenues represent a small portion of total revenues for most of these banks."

The report also noted that total credit exposure, the sum of netted current exposure plus potential future exposure, decreased \$27 billion in the second quarter to \$752 billion.

“The modest decline in total credit exposure masks a lot of very large changes in the individual components that make up this number,” said Ms. Dick. “The rise in interest rates caused a very large decline in both derivatives receivables and payables.” The mark-to-market gain on derivatives receivables (gross positive fair values), declined \$307 billion, or 23.5%, to \$1 trillion. The mark-to-market loss on derivatives payables (gross negative fair values), declined by \$312 billion, or 24.3%, to \$971 billion. “Because both receivables and payables declined so significantly, so too did netting benefits. When payables and receivables both fall, netting benefits tend also to fall, because banks are not only owed less by their big clients, but they also owe those same clients less,” noted Ms. Dick.

Potential future exposure, which is an estimate of how high credit exposure on existing contracts can become over time, increased \$7 billion, largely due to increases in the notional amounts of derivatives contracts over 5 years.

Credit risk performance indicators confirmed the positive view of credit quality as reflected by narrow 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 \$72 million, or .065 percent of total credit exposure from derivative contracts. Derivatives charge-offs for the quarter were \$40 million, and represent .00531 percent of total derivative exposures, well below the .12 percent for C&I loans.

During the second quarter, the notional amount of interest rate contracts increased by \$4.4 trillion, to \$70.6 trillion. Foreign exchange contracts decreased by \$187 billion to \$7.8 trillion. This figure excludes spot foreign exchange contracts, which decreased by \$28 billion, to \$672 billion. Equity, commodity and other contracts decreased by \$18 billion, to \$1.2 trillion. Credit derivatives increased by \$284 billion, to \$1.5 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 second quarter derivatives report also noted that the number of commercial banks holding derivatives increased by 36, to 637.

A copy of *OCC Bank Derivatives Report: Second Quarter 2004* is available on the OCC Web site: www.occ.treas.gov.

###

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.