

Earnings from Bank Trading Activities Continue to Increase in Third Quarter, as Derivative Activities and Risk Exposures Remain Relatively Stable

Revenues from bank trading activities, including derivatives, increased by 19 percent in the third quarter, according to bank call report data released today by the Office of the Comptroller of the Currency (OCC).

The data also show relative stability in bank derivatives activities and risk levels. The notional volume of outstanding derivatives transactions increased slightly, while credit exposure declined slightly and market exposure remained relatively balanced compared to second quarter figures.

The overall number of banks engaging in off-balance sheet derivatives increased by 5 to 595 in the third quarter. Nine large institutions accounted for the vast majority of trading and derivatives activities.

Earnings: Trading revenues from cash and off-balance sheet positions totaled \$1.9 billion in the third quarter for all banks, an increase of \$310 million compared to the second quarter. The top nine banks accounted for 86 percent of that amount. Revenue for the year so far is \$4.6 billion.

Revenues from interest rate contracts, which comprise 64 percent of the bank derivatives market, rose \$39 million to \$962 million in the third quarter. Revenues from foreign exchange contracts, which account for 34 percent of the market, increased by \$242 million to \$762 million for the same period. Equity and commodity contracts, which represent 2 percent of the market, generated earnings of \$217 million, an increase of 15% from the second quarter. (See table 7, Graph 6).

Derivatives Growth: The notional amount of derivatives in commercial bank portfolios increased by \$243 billion in the third quarter to \$17.6 trillion. The \$243 billion increase exceeds the \$71 billion increase in the second quarter but is less than the \$2.2 trillion increase in the first quarter.

The composition and types of contracts in bank derivatives portfolios remain relatively unchanged since 1991. During the third quarter, increases in foreign exchange, commodity and equity contracts slightly offset a small decline in interest rate contracts. Over-the-counter and exchange traded contracts comprised 85% and 15%, respectively, of the notional holdings as of the third quarter, unchanged from second quarter concentrations. (See Table 3, Graph 3).

Credit Exposure: The third quarter saw a \$7.8 billion decrease in total credit exposure from off-balance sheet contracts to \$223 billion. Total credit exposures for the top nine banks averaged 251% of risk-based capital compared to 269% at the end of the second quarter. This decrease in exposure largely resulted from changes in currency and interest rates and recognition of continuing benefits from bilateral netting.

(See Table 4, Graph 5).

Market Risk: Banks continue to maintain relatively balanced derivatives trading portfolios. Market risk can be gauged by measuring the positive and negative fair values of derivatives portfolios. A portfolio has positive fair value if liquidation today would result in net income to the bank. A portfolio has negative fair value if liquidation today would result in a net loss to the bank. Relatively balanced exposures mean that the value of positions where the bank could have a gain does not significantly differ from the value of positions where the bank could have a loss. (See Table 6).

Structured Notes and High-Risk Mortgage Securities: The vast majority of banks reporting either structured notes or high-risk mortgage securities had total assets under \$1 billion. Depreciation for both types of securities continued to decline during the quarter. The reduction in depreciation stems largely from the decline in interest rates during the third quarter. (See Tables 8 & 9, Graphs 10 & 11).

To obtain a copy of the tables and graphs you can call Spectrafax (202) 479-0141 and request document number 795136.

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