



NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

NR 2001-54

FOR IMMEDIATE RELEASE
June 18, 2001

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OCC Reports Record Derivatives Trading Revenue for Banks

WASHINGTON -- U.S. commercial banks earned a record \$4 billion from cash instruments and derivatives activities in the first quarter of 2001, an increase of \$1.2 billion over the fourth quarter of 2000. The notional amount of derivatives in insured commercial bank portfolios increased by \$3.4 trillion in the first quarter, to \$43.9 trillion.

“The strong first quarter revenues reflected a number of positive factors, including a large volume of public debt issuance, which tends to generate client derivative transactions, and favorable positioning in anticipation of both narrower credit spreads and rate cuts by the Federal Reserve,” said Michael Brosnan, OCC Deputy Comptroller for Risk Evaluation. “The ability of commercial banks to tailor risk management solutions for their clients, and manage the resulting portfolio of risks effectively, continues to generate a consistent source of revenue for dealer banks.”

In its *Bank Derivatives Report, First Quarter 2001*, the Office of the Comptroller of the Currency reported that while the record notional amount of derivatives is a reasonable reflection of business activity, it is generally not an amount at risk. The risk in a derivative 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 credit worthiness of the counterparties in the transaction.

The report noted that total credit exposure, which consists of both current credit exposure as well as potential future exposure, increased \$63 billion in the first quarter to \$496 billion.

“Credit exposures showed a strong increase because volumes increased and contract mix continues to trend toward longer maturities, particularly in interest rate and foreign exchange contracts,” said Mr. Brosnan. “The longer term contracts require more capital, and this had an impact in the first quarter.”

Notwithstanding the overall increase in credit exposures, Mr. Brosnan underscored that “the benefits achieved from legally enforceable netting remains constant at 70% and quarterly charge-offs remain small both in terms of total dollar amount and as a percentage of capital.”

The report detailed that derivative contacts past due 30 days or more were only \$49 million, or .01 percent of total credit exposure from derivatives contracts. During the first quarter of 2001 banks charged off \$2 million due to credit losses from derivatives, or .0004 percent of total credit

exposure from derivative contracts. For comparison purposes, net loan charge-offs relative to total loans for the quarter were .18 percent.

During the first quarter, the notional amount of interest rate contracts increased by \$2.8 trillion, to \$35.7 trillion. Foreign exchange contracts increased by \$652 billion to \$6.75 trillion. This figure excludes spot foreign exchange contracts, which increased by \$221 billion to \$410 billion. Equity, commodity and other contracts grew by \$15 billion to \$1.1 trillion. In that total, however, credit derivatives fell \$74 billion, only the second time the product has declined since the OCC began tracking it in 1997.

“There had been some concerns about restructuring, which is one of the definitions of a “credit event” that can trigger a payment,” said Mr. Brosnan. “As these concerns are resolved, we expect to see this product begin growing again.”

End-user derivative contracts, after having fallen in the third and fourth quarters of 2000, remained flat at \$1.2 trillion in the first quarter. “It looks like the overhang from the uncertainties of FAS 133 might have run its course in the first quarter,” Mr. Brosnan said.

The top seven commercial banks engaged in trading account for 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 first quarter derivatives report also noted that:

- Revenues from interest rate positions increased by \$832 million, to \$1.9 billion, while revenues from foreign exchange positions increased by \$35 million to \$1.3 billion. Revenue from equity, commodity and other trading positions increased by \$372 million in the first quarter, to \$777 million.
- Long-term contracts (maturity of five years or more) increased from the third quarter by \$1.4 trillion to \$7.6 trillion. Notional amounts for interest rate contracts with maturities of one to five years grew in the first quarter by \$375 billion to \$11.1 trillion. Short-term (less than one year) interest rate contract notional volumes increased by \$1.1 trillion to \$15.4 trillion.
- The number of commercial banks holding derivatives decreased by five to 395.

A copy of *OCC Bank Derivatives Report: First Quarter 2001* is available on the OCC Web site: www.occ.treas.gov.

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The OCC charters, regulates and examines approximately 2,200 national banks and 56 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.