



# Derivatives. Low exposure of banks in Italy

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The value exceeds 10 trillion but rests on low-risk underlying assets

But don't be misled by the sky-high figures. Although the Over the Counter (OTC) derivatives used by Italian banks have surpassed the USD 10 trillion mark, analysts are not unduly worried. In this respect, the country's impact internationally is relatively marginal. So the notional value of derivatives, i.e. the value of the underlying financial assets, is not in itself an indicator of absolute risk. There are some variables in play that should be considered. First of all, the type of derivatives. For example, interest rate derivatives have sky-high notional values, but very low volatility and market risk. Then you need to know whether the instruments are used for hedging or trading. It is also important to know who the contract counterparties are.

## Comparison with Europe

"The latest Bankitalia statistics," explains Francesco Castelli, bond manager at [Banor](#), "based on the Bank for International Settlements' survey of OTC derivatives show a notional value of just over \$ 10 trillion for the major Italian banks. Looking closely at this data, we see that the exposure is predominantly on interest rates, therefore low risk, and that Italian banks' overall exposure to derivatives is quite low compared to the international and European average. Leading banks such as Intesa Sanpaolo and Unicredit offer derivative services mainly to non-financial corporations and therefore

have much lower volumes and notional values. In terms of trading volumes, Italy is in eleventh place worldwide for interest rate derivatives, so it is less exposed than its main competitors."

Amounts traded have also increased in this country in recent years, probably because the banks have prepared for the end of zero rates; but the impact on global amounts still remains low. Italy's position slips further in the rankings for instruments used in forex, where London is the biggest international marketplace in terms of trading volumes. "Derivatives," Castelli concludes, "often make an impression because of the huge figures involved. To illustrate this, just compare Deutsche Bank, which at the end of 2021 had € 40,000 billion of derivatives (nominal) and € 1,500 billion of assets on its balance sheet, with Intesa Sanpaolo, which reported € 2,600 billion of derivatives (nominal) and € 1,000 billion of assets. Deutsche Bank is one of the world's biggest players in interest rate derivatives and this swells the figures a lot. Today, however, derivatives are almost all collateralised and closer international attention puts them under greater scrutiny even if volumes remain high."

## Financial Statements 2022

Bankitalia data on the OTC derivatives of major Italian banks show a general increase in the use of the instruments: the figure in June 2022 was just over 8% up from the end of December 2021. Guido

Gennaccari, analyst and founder of TradingRoom Roma, comments, "The biggest rise above the 9% mark was in interest rate derivatives. Rates are a very hot topic since this is a very delicate point in history. A decade of ultra-expansive monetary policies has come to an end and an unexpected and dramatic inflation hike has led to an unprecedented monetary squeeze. The pressure on rates is also reflected in interest rate derivative trading volumes, which in Italy rose from € 261 billion to € 417 billion between 2019 and April 2022." The levels have almost doubled. The market has probably prepared itself ahead of time for the monetary squeeze by the major central banks including the ECB."

Gennaccari concludes, adding, "Still with derivatives, there has been a 15% increase in the value of CDSs. However, Italian banks' derivatives have a total value of around € 10 trillion, and, compared with the € 4 trillion in intangible assets of the major Italian institutions, the ratio is not overly disproportionate. We are talking about derivatives, which are instruments used mainly to hedge risks."

## FOCUS

### Global trends

OTC derivatives are showing steady growth globally. In 2002, their notional value was around € 620 trillion. This is more than six times the global GDP forecast for this year. They are instruments that replicate underlying assets (interest rates first and then currencies) with forward

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delivery. It is a steadily growing market: the value of derivatives has increased by € 100 trillion since 2007, the year before the outbreak of the great financial crisis. It is no coincidence that in the past few days the Bank for International Settlements has sounded an alarm mainly for the Forex situation (where derivatives total just under € 100 trillion in swaps and forwards).

## GLOSSARY

### OTC Derivatives

These are financial instruments that derive their value from an underlying asset. They are basically futures contracts linked to various areas (interest rates, foreign exchange, etc.).

At a certain maturity the parties opt or undertake to deliver/purchase the underlying value. OTC (Over the Counter) derivatives are unregulated. The notional value is the value of the derivative's associated financial asset. "Mark to market" is instead a method of measuring the contract value on a certain date. The value can therefore vary over time.

### Forex

The foreign exchange market, also known as the currency market or forex, was the first financial market, and was created to allow countries to exchange currencies. Unlike other markets, it does not have a fixed location; instead, its transactions take place directly between the parties involved, in the OTC market.

### Swap

This is exactly what it seems: "To exchange something for something else". A swap is a contract in which counterparties A and B agree to exchange sums of money (usually the difference between the two) in accordance with the contract specifications, which determine the

classification of swap contracts by type. An IRS (Interest Rate Swap) is a contract in which two counterparties agree to exchange cash flows – one of them fixed rate and the other floating rate – over a period of time.

### CDS

A CDS (Credit Default Swap) is a contract in which the credit holder (protection buyer) agrees to pay a fixed regular sum, usually expressed in basis points in relation to a notional principal, to the counterparty (protection seller) who in turn takes on the credit risk for that asset in the event of an undefined future default incident (credit event). The regular sum paid by the creditor is generally commensurate with the risk and probability of insolvency of the third party debtor.

### Forward

A forward rate agreement is an interest rate contract under which two counterparties undertake to exchange, on an agreed future date, a specified amount of liquidity calculated on the basis of a fixed interest rate set at the signing of the agreement, and a variable interest rate, as it stands at the agreed future date.

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## BANKS AND DERIVATIVES. Current status of exposures of Italian lenders

### DERIVATIVE CONTRACTS BY RISK CATEGORY

Billions of dollars and percentages

RISK CATEGORY	NOMINAL OR NOTIONAL AMOUNTS OUTSTANDING				COMPOSITE ON JUNE '22	GROSS MARKET VALUE AS AT JUNE 2022	
	DECEMBER 2021	JUNE 2022	% CHANGE '21 AND JUNE '22	DECEMBER 2021		POSITIVE	NEGATIVE
<b>FINANCIAL DERIVATIVES</b>							
<b>Exchanges</b>	811.1	814.6	0.4	7.5	20.2	21.4	
<b>Interest rates</b>	9,093	9,956.8	9.5	91.1	239.7	234	
<b>Equities and goods</b>	147.5	156.4	6	1.4	9.6	16.7	
<b>TOTAL</b>	10,051.6	10,927.8	8.7	100	269.5	272.1	
<b>CREDIT DERIVATIVES</b>							
<b>CDSs bought</b>	132.5	151.3	14.2	49.9			
<b>CDSs sold</b>	129.4	151.8	17.3	50.1			
<b>TOTAL</b>	261.9	303.1	15.7	100	4	4.2	

### INTEREST RATE DERIVATIVES

Nominal or notional amounts outstanding as at June 2022. Billions of dollars

INSTRUMENTS	DOLLAR	EURO	YEN	STERLING	OTHERS	TOTAL
<b>Forward rate agreements</b>	10.9	1,305.8	--	--	1.8	1,318.5
<b>Swaps</b>	626.1	7,338.2	19	63.1	134.3	8,180.7
<b>OTC options</b>	27.3	428.6	--	1.5	0.3	457.6
of which: sold	14.5	226.5	--	0.7	0.2	241.9
purchased	12.8	202.1	--	0.8	0.1	215.7
<b>TOTAL</b>	664.2	9,072.6	19	64.6	136.4	9,956.8

### EXCHANGE RATE DERIVATIVES

Nominal or notional amounts outstanding as at June 2022. Billions of dollars

INSTRUMENTS	DOLLAR	EURO	YEN	STERLING	OTHERS	TOTAL
<b>Forward rate agreements</b>	369.9	385.1	12.8	40.3	130.1	469.1
<b>Swaps</b>	204.7	175.2	23.9	28.3	66.5	249.3
<b>OTC options</b>	79.9	85.1	2.5	3.2	21.6	96.2
of which: sold	40.7	43.3	1.2	1.5	10.7	48.7
purchased	39.2	41.8	1.4	1.7	10.9	47.5
<b>TOTAL</b>	654.5	645.4	39.2	218.2	218.2	814.5

Source: Bankitalia

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