OTHER COMPREHENSIVE INCOME

OCI — the gains and losses that never pass through profit or loss, yet still move a bank's CET1.

BANKING METRIC SERIES

#1 Basel Accords

→ **#2 Capital**

#3 RWA

#4 Capital Ratio

#5 LCR

#5 NSFR

#6 ECL

Income That Skips the Income Statement

Some gains and losses are real but not yet realised. Accounting parks them in equity — not in profit or loss.

Other Comprehensive Income (OCI) collects the value changes that standards keep out of the income statement and book straight into equity. The running total sits in a reserve called Accumulated OCI (AOCI).

WILL RECYCLE TO P&L

Booked back into profit when realised

- Debt securities at Fair Value — e.g., a bond prices move with rates and spreads
- Effective portion of cash-flow hedges
- Translation of foreign operations (FX)

WILL NOT RECYCLE

Stays in equity, forever

- Equity instruments at Fair value (IFRS 9 election)
- Remeasurements of defined-benefit pensions (IAS 19)
- Own credit risk on fair-valued liabilities

Why does the split matter?

When a recycling item is finally sold (e.g., a bond before maturity), its accumulated gain or loss leaves OCI and lands in that year's profit. Non-recycling items never make that trip — they are settled straight against reserves. The distinction decides where the number eventually shows up in the accounts. It does not change the fact that the value already sits inside the bank's equity today.

KEY TAKEAWAY

OCI is the waiting room of the income statement. The value has already moved; the gain or loss is simply not locked in yet — but it still sits inside equity.

How OCI Reaches CET1

Basel III made a deliberate choice: capital should reflect fair value, even on paper.

The rule: full inclusion

Basel III lists accumulated OCI among the components of CET1 and removed the old Basel II filter that let banks strip unrealised gains and losses on available-for-sale securities out of capital. The logic: if fair value has fallen, the loss is economically real even if not yet realized, so the ratio should already show it.

$$\text{CET1 reserves} = \text{AOCI} - \text{cash-flow hedge reserve} - \text{own-credit / DVA} - \text{AVA}$$

The few filters that survive (CRR Art. 33–34)

- **Cash-flow hedge reserve —** A bank swaps its floating-rate funding to fixed to lock the cost. Rates rise and the swap gains €4m — but that gain skips the P&L and waits in OCI. The funding it hedges isn't carried at fair value, so the reserve shows only half the hedge. That's why CRR strips it out of CET1.
- **Own credit risk —** gains from your own falling creditworthiness on fair-valued liabilities, and derivative DVA, are removed.
- **Prudent valuation —** Additional Valuation Adjustments trim fair-valued positions to a conservative exit price

KEY TAKEAWAY

Almost all of OCI flows straight into CET1, despite being a gain or a loss not yet realized.
Basel keeps only the filters that would otherwise flatter capital and trims the rest with prudent valuation.

When Rates Move, CET1 Moves

Through OCI, interest-rate risk in the bond book becomes a live capital number.

SVB — END 2022 (FED ESTIMATE)

−1.7pp

the CET1 hit SVB kept off its ratio by electing the US AOCI opt-out — about −$1.9bn.

The mechanism

Fixed-rate bonds at FVOCI lose value when rates rise. That loss lands in the OCI reserve and — in the EU — directly inside CET1. No default, no sale, yet capital falls. OCI is the channel that turns interest-rate risk in the banking book into a capital number.

The 2023 contrast

In the US, smaller banks may elect to leave AOCI out of CET1. Silicon Valley Bank did exactly that, so its ratio ignored large unrealised bond losses — until it sold $21bn of securities at a $1.8bn loss, crystallised the damage and triggered a run. Under EU rules there is no opt-out: the loss would already have been visible in CET1.

OCI is where today's interest-rate risk quietly becomes tomorrow's capital hit — and in Europe it is already inside CET1.

This is Episode 8 of the Banking Metrics Series. Each episode takes one key metric, breaks it down from first principles, and illustrates it with real data. No jargon, just clarity.