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[Buffett Exits Credit Derivatives, Pays $195 Million on Last Deal.]

Warren Buffett just took another step to simplify Berkshire Hathaway Inc.'s stockpile of derivatives.

The company paid $195 million in July to wind down the last contract in which Omaha, Nebraska-based Berkshire provided protection against losses on bonds, according to a regulatory filing Friday that didn't identify the counterparty. As of June 30, the maximum risk on that credit-default agreement was about $7.8 billion.

Buffett labeled derivatives "financial weapons of mass destruction" in 2003, but went ahead and entered a number of the contracts in the following years. The billionaire has argued that agreements he made were attractive because they gave him money up front that he could invest. Berkshire's derivatives also differed from contracts that brought down other financial institutions during the 2008 credit crisis, because he had less onerous collateral requirements.

Still, Berkshire's derivatives have been the source of some pain. In 2008, the U.S. Securities and Exchange Commission asked Berkshire to make "more robust disclosure" on how it valued the contracts, which the company eventually did. The following year, Moody's Investors Service and Fitch Ratings cited derivatives when the ratings firms stripped Berkshire of its top credit grade. Changes in the values of the contracts are reflected on Berkshire's income statement, sometimes causing wild swings in quarterly profit.

"That was a very interesting chapter for Berkshire and its shareholders," said David Rolfe, chief investment officer at Wedgewood Partners, a Berkshire investor that oversees about $7.8 billion. "And it looks like that chapter is winding down."

Sparing Successor

Berkshire's last credit derivative had such a long potential lifespan that it could've continued under the next chief executive officer. Buffett may have been thinking, "why even bother someone with that?" Rolfe said.

Buffett, 85, has told shareholders to look past the fluctuations from derivatives and focus instead on the underlying earnings for Berkshire's dozens of businesses, from railroad BNSF to ice-cream chain Dairy Queen.

On Friday, the company reported that operating earnings climbed 18 percent to $4.61 billion in the second quarter, driven by gains at insurance and manufacturing businesses.

The contract covered in the July agreement was written in 2008 and related to municipal debt issues with maturities from 2019 to 2054, according to regulatory filings. Buffett didn't respond to a request for comment outside normal business hours.

For years, the billionaire has been winding down derivatives or letting them expire. In 2012, he struck a deal to terminate contracts linked to municipal bonds. Others tied to corporate debt expired the following year.

‘Minor Positions’

Concerns about derivatives holdings could prove inconvenient during market crises — times when Berkshire has typically used its financial strength to seize opportunities and make lots of money.

“When you have to mark these contracts to market in a downturn like 2008, it gives the appearance that Berkshire’s fortress balance sheet is weakened,” said Richard Cook at Cook & Bynum Capital Management, which oversees about $350 million including Berkshire shares. “I would prefer Buffett to have as much flexibility as possible when the tide rolls out.”

Berkshire still has some derivatives tied to the performance of stock indexes. Potential liabilities on those agreements have narrowed in recent years as markets rallied. Liabilities on the equity index puts — which expire between June 2018 and early 2026 — stood at about $4.4 billion at the end of the second quarter.

Some of Berkshire’s energy businesses also use derivatives to hedge fuel costs. But Buffett has been downplaying the role the contracts will play at his company when he’s no longer around.

“I don’t think there’ll be much of a derivatives book” under a new CEO, he said at Berkshire’s annual shareholder meeting in 2012. “There are a few operating businesses that will have minor positions.”

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