1998
Survey of
Credit Underwriting
Practices

National Credit Committee

Contents

Introduction

The Office of the Comptroller of the Currency (OCC) conducted its fourth annual Survey of Credit Underwriting Practices during the second quarter of 1998. The purpose of the survey is to identify trends in credit risk within the national banking system. The questionnaire-based survey addressed changes in lending standards since the 1997 survey for the most common types of commercial and retail credit offered by national banks. The OCC examiners-in-charge of the 77 largest national banks were asked to respond to survey questions based on their first-hand knowledge of the banks they supervise. The Comptroller's National Credit Committee subsequently analyzed the results of the survey. This committee includes a cross-section of the most experienced credit examiners from around the country, along with senior OCC staff representing a variety of policy disciplines within the agency. The committee's members have an average of over 20 years of experience in bank regulation.

Primary Findings

For the fourth consecutive year, underwriting standards for commercial loans have eased. Also, easing is now more widespread among the surveyed banks. Examiners again cite competitive pressure as the primary reason for easing underwriting standards.

The percentage of banks easing commercial underwriting standards has increased since last year's survey. Examiners at 69 percent of the surveyed banks — compared with 59 percent in 1997— report eased underwriting standards for one or more types of commercial loans. This trend was most pronounced in syndicated/national, middle market, and commercial real estate lending.

Pricing concessions continue to be the most prevalent method used by surveyed banks to ease underwriting standards. Examiners also report that increasing numbers of surveyed banks are granting structural concessions to their borrowers. They cited liberalized financial covenants, reduced guarantor and collateral requirements, and extended maturities and amortization schedules as evidence of eased commercial loan standards among the surveyed banks far more often than in previous surveys.

Banks are continuing to tighten their lending standards for most retail loans. *Home equity products, where eased standards prevailed, are an exception.*

Examiners reported tightened retail lending standards most often in indirect, credit card, and leasing portfolios. These tightened lending standards resulted in a shift toward more conservative standards for the overall retail portfolios of the surveyed banks. Examiners most often identified a change in a bank's risk appetite or a revised market strategy as reasons for tightening retail standards. Although signs of overall tightening were evident, aggressive underwriting practices continue to exist for certain banks that are active participants in the market. These practices were most prevalent in the credit card and indirect consumer lending products.

Examiners in the majority of surveyed banks reported that lenders had raised minimum cut-off scores to tighten retail underwriting standards. They also noted that many surveyed banks tightened standards by tightening pricing and structural requirements.

A large number of examiners identified the lending standards for home equity products as having been eased. They also identified this product line as a new or growth product in several of the surveyed banks.

Examiners characterized all credit products, both commercial and retail, as having increased levels of inherent credit risk. This trend is expected to continue.

Compared with a year ago, examiners report that the level of inherent credit risk is increasing for all portfolios. In commercial loan portfolios, examiners most frequently cited higher inherent risk in the syndicated/national, middle market, and commercial real estate portfolios. Projecting over the next 12 months, credit risk is expected to further increase in all commercial portfolios, with the most significant increases centered in the three aforementioned portfolios.

Despite two consecutive years of tightening standards, credit risk for retail products is still increasing. This results from the lagged effect between a change in underwriting and the risk profile of a loan portfolio. The majority of the loans in bank retail loan portfolios today were underwritten prior to 1997. Loans underwritten using the tighter underwriting standards implemented during the past two years do not yet comprise a majority of the portfolio. Further, while retail underwriting standards are reportedly tightening, external factors, such as the rise in personal bankruptcies, also influence the level of risk in retail credit portfolios. Consumer leasing, indirect lending, and credit cards were the retail products examiners most frequently identified as having higher inherent risk. Examiners expect this trend to persist over the next 12 months, with the most significant increases in risk expected in consumer leasing, home equity, and direct consumer loans.

Survey Population and Scope

The 1998 survey was conducted at the national bank affiliates of the 77 largest bank holding companies. Although mergers and acquisitions have altered the survey population somewhat since 1997, the surveys for the past three years have covered substantially the same bank group. Since the 1997 survey, however, the OCC no longer uses Tier I, Tier II, and Tier III designations to group banks by size. Instead, the OCC has designated 32 banks as “large banks.” These banks generally report assets in excess of $20 billion. (Hereafter, references to “large banks” will refer to this group of 32 banks and references to “mid-size banks” will refer to the remaining survey population.)

All banks in the 1998 survey have assets of $2 billion or greater. The aggregate loan portfolios of banks included in the 1998 survey was approximately $1.6 trillion as of March 31, 1998, or 86 percent of all outstanding loans in national banks. This compares with aggregate loan portfolios of $1.5 trillion as of June 30, 1997.

Examiners participating in the survey were asked to answer a series of questions about 13 common types of commercial and retail credit. Their responses are based upon their knowledge of the banks’ lending activities. For the purposes of this survey, commercial credit consisted of six categories of loans: syndicated/national loans, middle market loans, small business loans, international credits, commercial real estate loans, and agricultural loans. The seven categories of retail credit were: residential real estate loans, affordable housing loans, home equity loans, credit cards, other direct consumer loans, indirect consumer loans (loans originated by others, e.g., automobile dealers), and consumer leasing.

The term “underwriting standards,” as used in this report, refers to the various factors (e.g., collateral requirements, loan maturities, covenants specifying maximum leverage or minimum debt service capacity) banks employ to originate and structure loans. Conclusions about “easing” or “tightening” of underwriting standards are based on the observations of OCC examiners concerning changes banks have made to their underwriting standards since the 1997 survey. A conclusion that the underwriting standards for a particular loan category have eased or tightened does not indicate that all the standards for that particular category have been adjusted, but rather that the adjustments made by the bank have the net effect of easing or tightening such underwriting criteria.

In addition to reporting about the easing and tightening of underwriting standards, examiners characterized the underwriting standards for each of the loan categories as “conservative,” “moderate,” or “liberal.” As each of these designations can cover a range of underwriting behaviors, some examiners reporting eased or tightened standards did not deem the changes significant enough to revise their overall assessment of the bank’s underwriting standards.

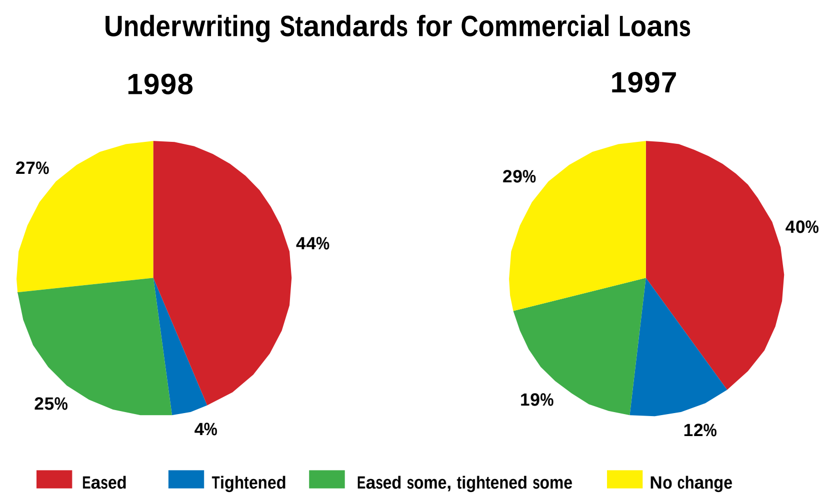
The 1998 underwriting survey questionnaire was sent to examiners in April, 1998, and therefore only covers credit underwriting standards observed during an 11-month period. For the sake of comparison, however, all references to previous surveys are expressed on an annual basis.

Part I of this report discusses the overall results of the survey. Because of the intrinsic differences between commercial and retail credit, the survey results will be discussed for each product grouping rather than by the total credit portfolio of the surveyed banks. Part II contains the results of the survey by type of loan product.

Part I — Overall Results

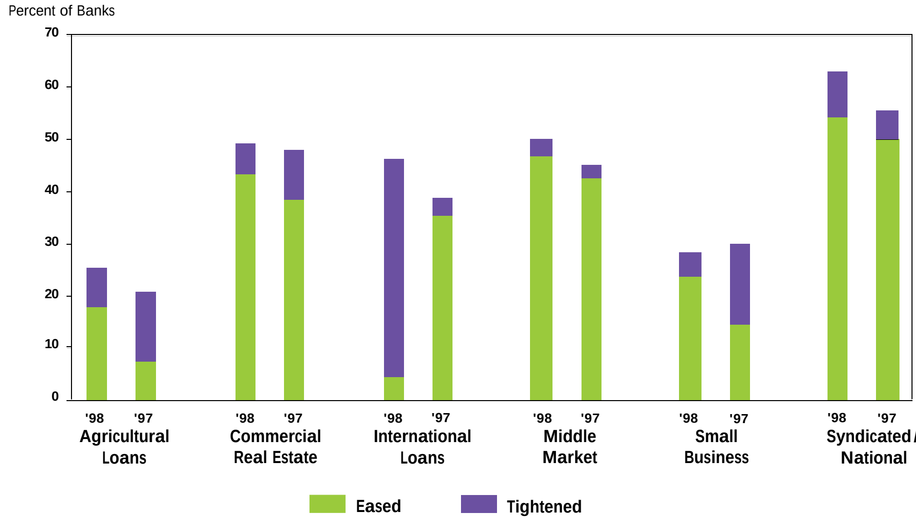
Commercial Underwriting Standards

Continuing the trend first emerging in 1997, a majority of the surveyed banks made changes to their underwriting standards for one or more categories of commercial loans during the last year. As the following charts show, an even greater proportion of banks eased or partially eased commercial underwriting standards in 1998 than in 1997. (Partial easing means that a surveyed bank eased standards for some commercial products but tightened them for others; e.g., eased middle market and syndicated/national credits but tightened standards for international loans.) Survey results indicate that 44 percent of surveyed banks eased and another 25 percent partially eased underwriting standards. Conversely, the number of banks reported to have tightened commercial standards dropped to less than 5 percent of the surveyed banks.



As depicted on the following chart, the easing of underwriting standards has occurred in all commercial product categories except international loans. (Underwriting standards for international credits were tightened, an apparent reaction to economic problems in Asia.) Easing was most pervasive in three commercial loan categories. The most significant easing occurred in syndicated/national lending, with 54 percent of the banks reportedly easing their underwriting standards, followed closely by middle market (47 percent) and commercial real estate lending (43 percent). Small business loans (24 percent) and agricultural lending (18 percent) also reflect eased underwriting standards.

Changes in Underwriting Standards for Commercial Loans



The easing of underwriting standards for syndicated/national, middle market, and commercial real estate lending raises particular concern. These portfolios comprise a significant portion of bank loan portfolios and, historically, have produced a majority of loan losses.

Eased Commercial Underwriting Standards

	Syndicated/National		Middle Market		Commercial Real Estate	
1998	25 banks	(54%)	31 banks	(47%)	30 banks	(43%)
1997	26 banks	(50%)	31 banks	(42%)	28 banks	(38%)
1997 and 1998	15 banks	(35 %)	15 banks	(23%)	14 banks	(22%)

Survey results for these products show a more pronounced and progressive trend toward easing standards than reported for other commercial loan products. Indeed, approximately 50 percent of the banks reported to have eased underwriting standards for these products in the 1997 survey continued that practice in the 1998 survey. In some instances the bank changed the same criteria; for example, pricing for syndicated/national loans was reported eased in both the 1997 and 1998 surveys. In other instances, different criteria were changed; for example, for middle market loans examiners reported the bank eased covenant requirements in 1997 and guarantor requirements in 1998. In either case, however, the net result is eased underwriting standards for two consecutive years for that loan category.

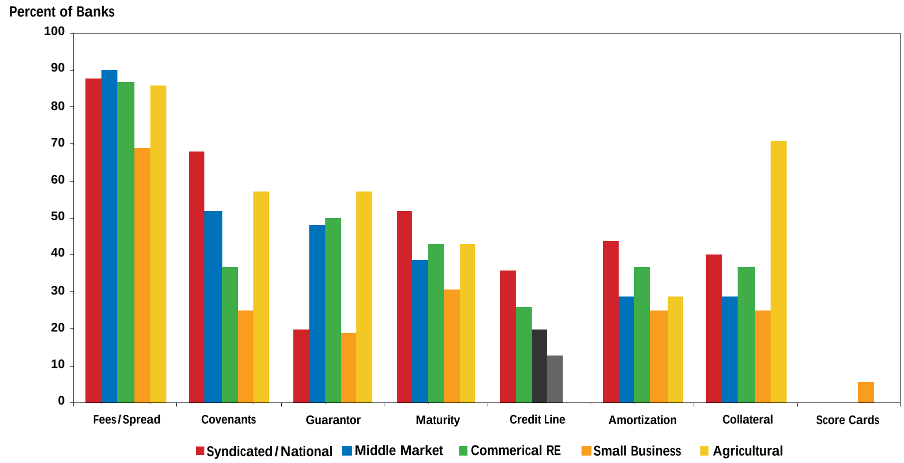
Types of Changes Made in Commercial Underwriting Standards

The following chart summarizes the methods used to ease standards. Across all categories of commercial loans, examiners cited lower pricing (thinner spreads) as the most common concession provided to borrowers. Eased pricing, in terms of loan fees and interest rates, was reported in 86 percent of the cases in which banks made changes in 1998, compared with 76 percent in 1997 (and only 42 percent in 1996.) Examiners also reported eased loan covenants in 47 percent of the banks in the 1998 survey, compared with 25 percent in 1997. Lengthened maturities were cited in 42 percent of the cases in which easing occurred in 1998, compared with 25 percent in 1997. Eased requirements for guarantors of commercial loans were reported in 38 percent of the banks in the 1998 survey, compared with 22 percent in 1997, and relaxed collateral requirements were observed in 35 percent of the banks as compared with 24 percent in the 1997 survey.

Only a few examiners reported tightened standards for commercial loans. They identified loan

Methods Used to Ease Commercial Underwriting Standards

(By Type of Loan - As Percent of All Banks Easing)



covenants as the most common method used to tighten standards.

In 1997, a trend toward granting multiple concessions to borrowers began to emerge. This trend has become more pronounced in 1998. For syndicated/national credits, examiners reported that 88 percent of the banks eased two or more criteria and 72 percent eased three or more criteria, compared with 61 percent and 42 percent respectively in 1997. This same pattern is evident for middle market loans (77 percent of banks eased two or more criteria and 65 percent eased three or more versus 65 percent and 42 percent in 1997) and commercial real estate (83 percent eased two or more criteria and 53 percent eased three or more compared with 64 percent and 32 percent in 1997). The pattern is also repeated for agricultural lending and is evident but less pronounced for small business lending.

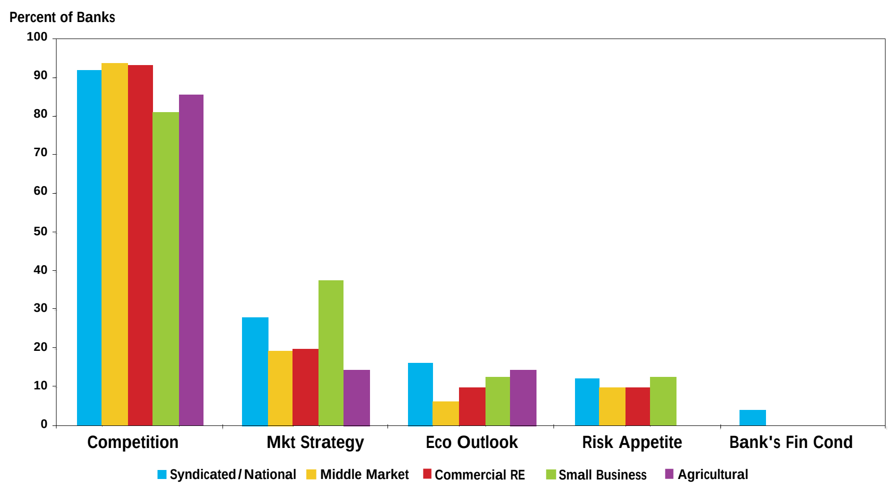
The increased practice of granting multiple underwriting concessions suggests that banks are leaving themselves with fewer options to control the risks associated with commercial lending should the economy falter or some other event threaten portfolios.

Reasons for Changes in Commercial Underwriting Standards

For banks that changed their underwriting standards since the previous survey, examiners were asked to characterize why they had tightened or eased their standards. The following chart depicts examiner assessments of the primary reasons for easing commercial lending standards.

Reasons for Easing Commercial Underwriting Standards

(By Type of Loan - As Percent of All Banks Easing)



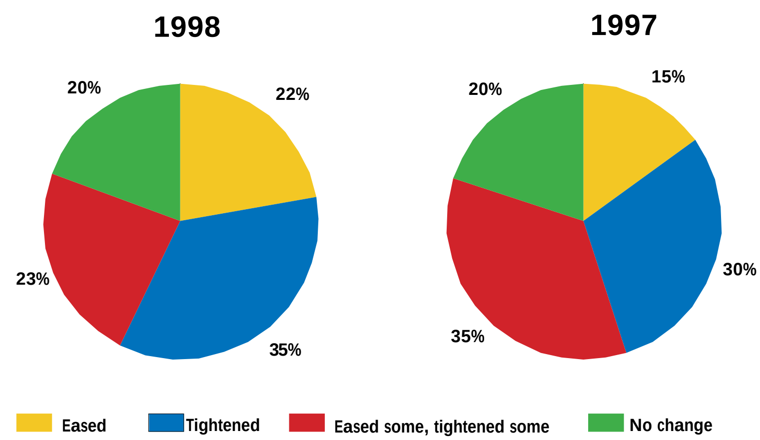
As in all of the previous surveys, examiners identified competition as the predominant reason for easing commercial underwriting standards. Market strategy generally lagged far behind as the second most common reason for easing standards.

With the exception of international lending, the number of banks reported to have tightened commercial underwriting standards was not material, and is not discussed.

Retail Underwriting Standards

The 1998 survey indicated that 81 percent of surveyed banks made changes to their underwriting standards for retail lending in at least one of the product categories since the last survey. As the following charts show, generally the same percentage of banks made changes in 1997, but the distribution between tightening and easing standards has shifted, with increased tightening reported in 1998. According to examiners, several banks have developed new guidelines for retail products, while others have either established or tightened their limits on overrides.

Underwriting Standards for Retail Loans

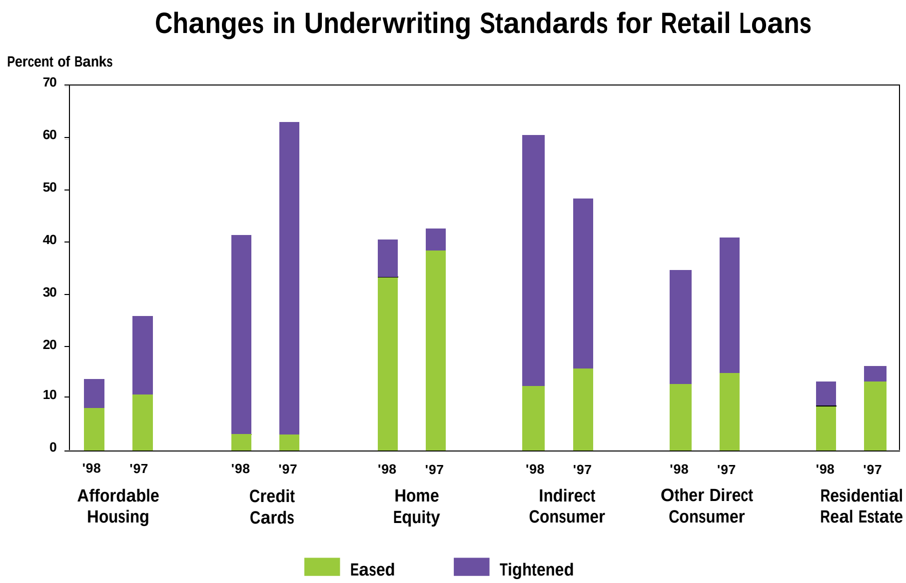


Retail products that have been most vulnerable to the rise in consumer delinquencies and charge-offs were most likely to be subjected to tightened underwriting standards; i.e., credit cards and direct and indirect consumer loans. At the same time, however, examiners reported that the underwriting standards for home equity products have been liberalized since the 1997 survey.

As depicted on the following chart, trends in underwriting standards for retail products discerned in 1997 continued into 1998. Examiners noted tightened retail standards for the same retail products cited in 1997— credit cards and direct consumer and indirect consumer lending.

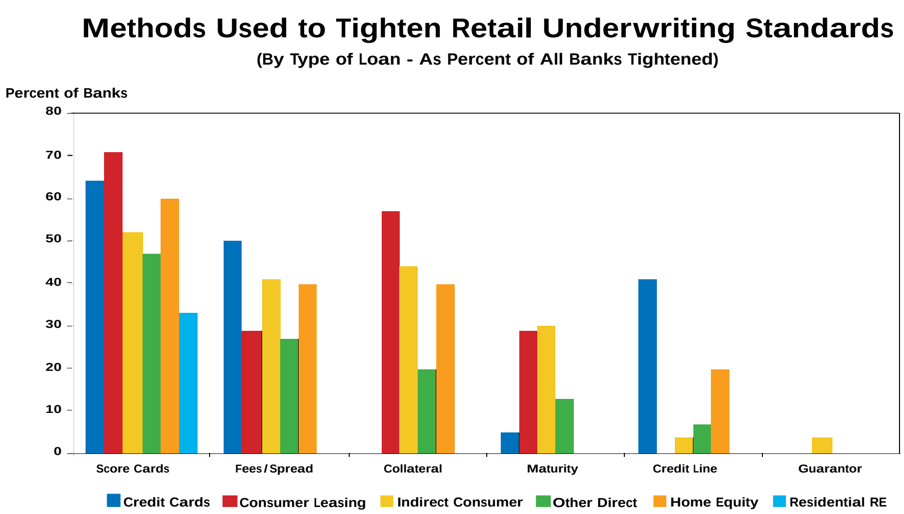
Indirect consumer lending replaced credit cards as the retail product for which examiners most frequently reported tightened standards in 1998. Examiners at 48 percent of the surveyed banks reported such tightened standards compared with 38 percent of credit card lenders reported to have tightened their standards. In 1997, examiners reported that 59 percent of surveyed banks tightened their credit card underwriting standards while only 33 percent of banks offering indirect consumer loans reportedly tightened their standards. Consumer leasing, added as a separate category of retail lending in 1998 (it was primarily reported under the indirect consumer lending category in 1997), also exhibited tightened standards.

Examiners reported that surveyed banks eased their underwriting standards for three retail products, but they reported significant easing only in home equity products. For home equity lending, 33 percent of banks offering this product eased standards compared with 7 percent who tightened standards. The 1998 survey marks the third consecutive year that examiners have observed liberalized underwriting standards for home equity products. Examiners also reported net easing for affordable housing and residential real estate lending.



Types of Changes Made in Retail Underwriting Standards

For all retail products, examiners reported scorecards; i.e., raising the minimum cut-off score, as the most common method to tighten underwriting (54 percent). Retail lenders also used pricing (37 percent) and collateral (28 percent) adjustments to tighten underwriting, but unlike commercial lending, where lenders adjusted several criteria, the majority of retail lenders tightened only one underwriting factor. For unsecured products, examiners reported reducing the amount of available credit (credit line) as the second most common adjustment, while for secured products collateral adjustments ranked second.



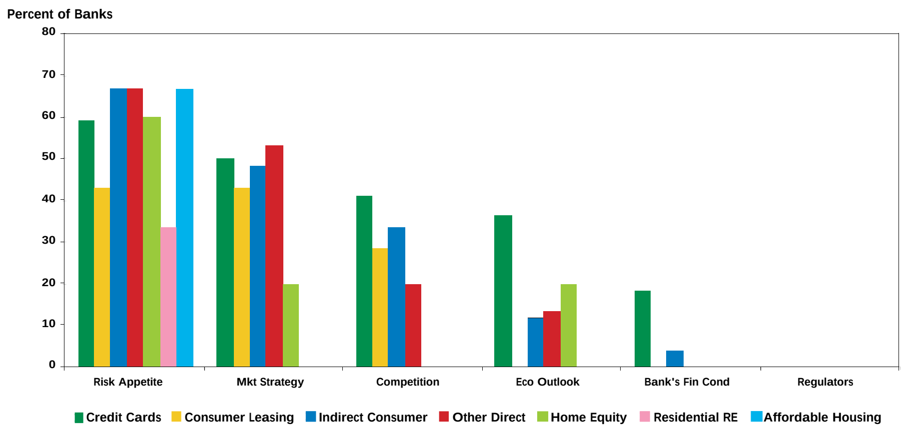
Home equity lending represented the only retail product for which standards were more likely to be eased than tightened. Methods used to ease standards, examiners reported, included changes to collateral requirements, typically the liberalization of loan-to-value ratios (52 percent). Other methods used to ease standards included adjustments to pricing and changes to amortization schedules.

Reasons for Changes in Retail Underwriting Standards

The following chart depicts risk appetite, market strategy, and competition as reasons examiners believed surveyed banks tightened their retail underwriting standards.

Reasons for Tightening Retail Underwriting Standards

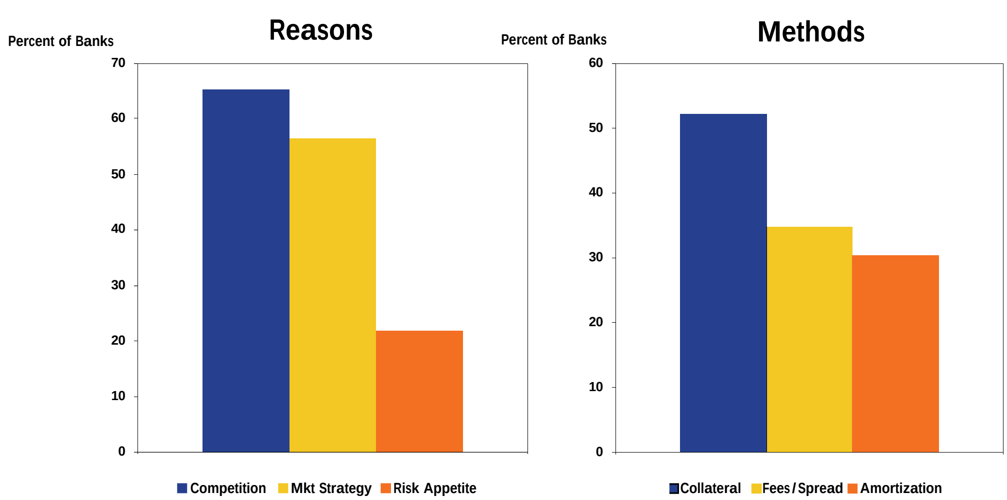
(By Type of Loan - As Percent of All Banks Tightened)



Examiner judgments about why credit card lenders tightened standards for underwriting were more diverse. In addition to change in risk appetite, market strategy, and competition, examiners also believed that tightened standards reflected a potential change in the economic outlook (36 percent). Other concerns specifically mentioned included the level of personal bankruptcies and the overall quality of retail credit.

For home equity lending, examiners reported that 65 percent of the banks easing standards did so for competitive reasons. Examiners also cited market strategy (57 percent) as a reason for easing standards.

Reasons and Methods Used to Ease Home Equity Underwriting Standards



Eased underwriting standards for other retail products offered by surveyed banks were limited.

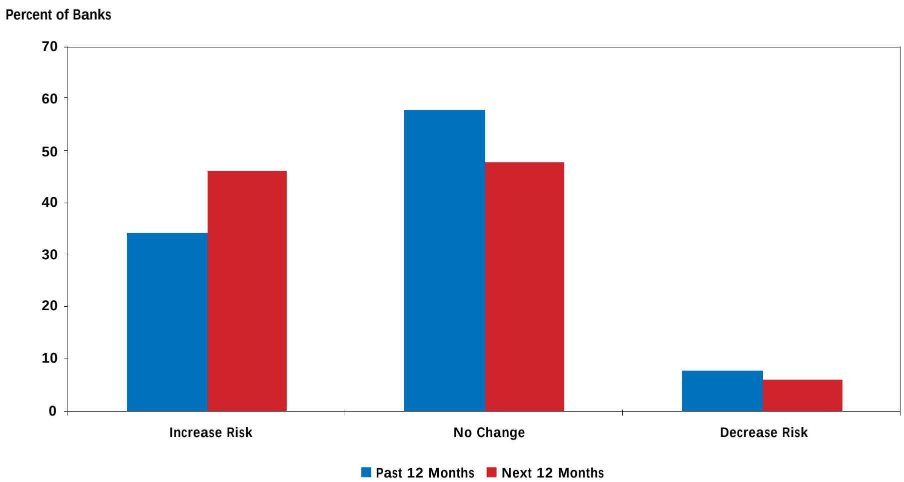
Portfolio Credit Risk

In addition to reporting on changes in underwriting, examiners were asked to characterize what had happened to the level of inherent credit risk in the bank's loan portfolio since the 1997 survey. They were also asked what they expect will happen to credit risk over the next 12 months. Examiners reported a net increase in credit risk for all credit products in retail and commercial portfolios since the previous survey. They also expect a net increase in credit risk over the next 12 months.

Credit Risk in Commercial Portfolios

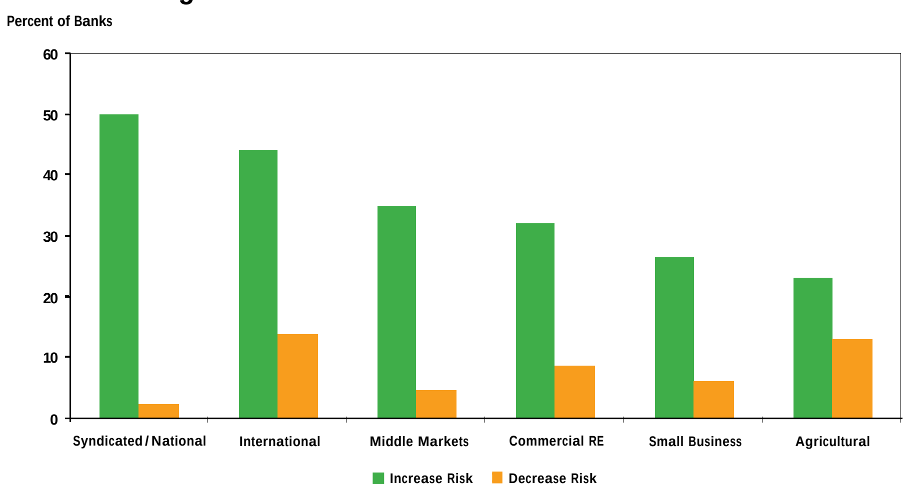
Results from the 1998 survey mark the third consecutive year that examiners have indicated a net increase in credit risk for commercial loan products. Examiners also expect a net increase in credit risk in commercial portfolios over the next year. The following chart depicts the change since the 1997 survey and whether examiners expect commercial credit risk to increase, decrease, or remain the same during the next 12 months.

Credit Risk in Commercial Loan Portfolios



As the following chart depicts, inherent credit risk is also judged to have increased on a product-by-product basis. For the second consecutive year, examiners believe syndicated/national credits pose significant increased risk — 50 percent of the examiners reported increased risk in their bank's syndicated/national credit portfolios in 1998 compared with 40 percent in 1997. Moreover, examiners expect credit risk to increase during the next 12 months in 59 percent of the banks active in this market.

Changes in Credit Risk in Commercial Products Since 1997

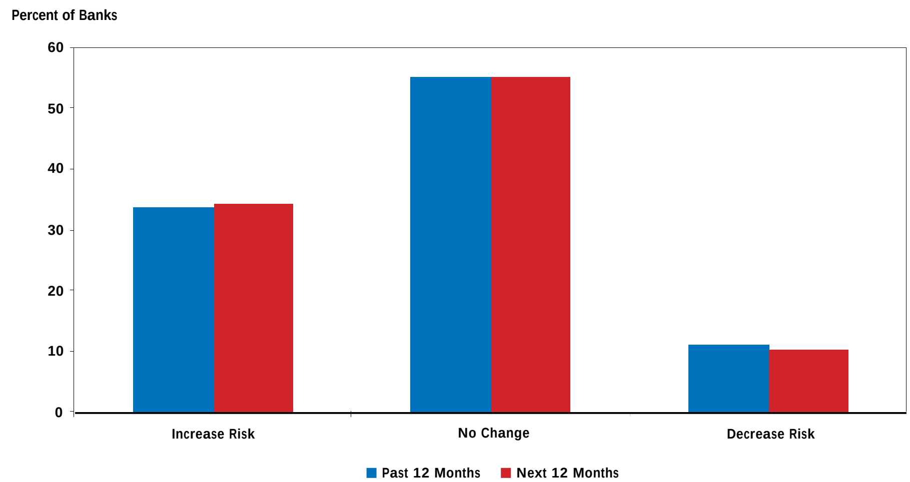


Credit Risk in Retail Portfolios

For the fourth consecutive year, examiners have indicated that inherent credit risk has increased in the majority of retail loan products offered by surveyed banks. Although underwriting standards for several retail product lines have been tightened during the last two years, examiners continue to report net increases in the overall level of risk, perhaps indicating room for further tightening. Examiners also expect a net increase in credit risk over the next 12 months at approximately the same rate experienced during the previous 12 months.

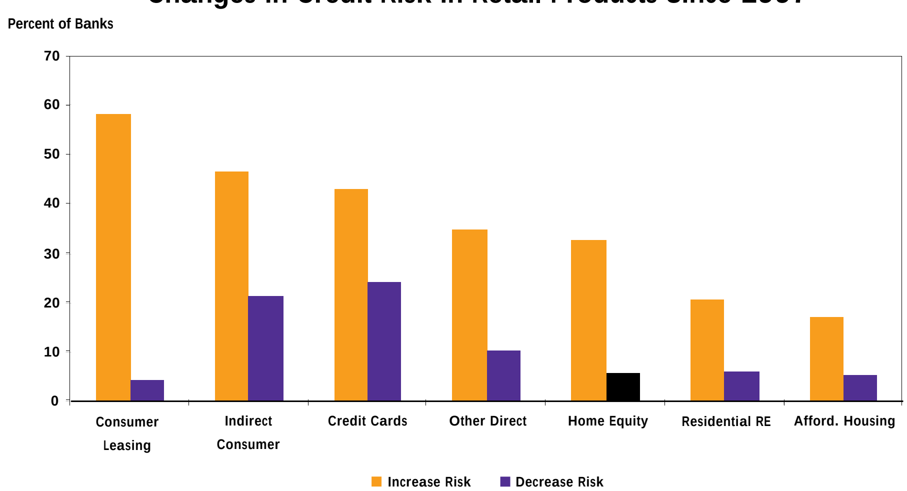
The following charts depict the changes in credit risk in retail portfolios since the 1997 survey and whether retail credit risk is expected to increase, decrease, or remain the same during the next 12 months.

Credit Risk in Retail Loan Portfolios



During the previous three years examiners also have reported net increases in credit risk for all retail products. For the 1998 survey, examiners report the greatest increased risk in credit card and indirect consumer portfolios. They also report that home equity lending, which continues to evidence relaxed underwriting standards, exhibits an increasing risk profile.

Changes in Credit Risk in Retail Products Since 1997



Part II — Results by Loan Type

Part II summarizes results of the survey by type of loan. Each discussion provides data on the number of surveyed banks engaged in that particular lending activity, whether examiners believe banks have tightened or loosened underwriting standards since last year's survey and, if they have, reasons for changing standards. Each section also summarizes examiner judgments as to whether the banks are conservative, moderate, or liberal lenders in that particular product.

Each discussion of the types of loans also has a table depicting examiner assessments of changes in underwriting standards for that particular type of loan. Another table illustrates trends in the level of credit risk since the 1997 survey and whether credit risk is expected to change during the next 12 months.

Commercial Lending Portfolios

Syndicated/National Credits

Of the 77 banks in the survey, 46 were active in the syndicated/national credit market. Across this population, the 1998 survey found eased standards in 54 percent of the banks, as compared with 50 percent in the 1997 survey. Fifteen banks eased their standards during both periods. Large banks, generally those reporting assets in excess of $20 billion, are more active in the syndicated/national credit market than other banks — and 71 percent of them were reported to have eased their standards.

Only four banks (nine percent) were found to have tightened standards in 1998 compared with three banks (six percent) in 1997.

Changes in Underwriting Standards in Syndicated / National Credit Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	18	73	9
1997	50	44	6
1998	54	37	9

Easing occurred in pricing (88 percent), financial covenants (68 percent), maturities (52 percent) and collateral requirements (40 percent). Survey results also indicate that the percentage of banks liberalizing such lending criteria increased over the levels reported in 1997. Examiners continued to cite competitive pressures (92 percent) as the predominant reason for easing, followed to a lesser degree by changes in market strategy (28 percent).

Examiners characterized current lending standards for syndicated/national credits as conservative at 41 percent of the surveyed banks, moderate at 52 percent, and liberal at the remaining 7 percent. These results represent an 11 percent shift from conservative to moderate since the 1997 survey.

Changes in the Level of Credit Risk in Syndicated / National Credit Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	8	52	40	0
1998	0	2	48	50	0
Future 12 Months	0	4	37	57	2

Middle Market Lending

Both the 1998 and the 1997 survey results indicate that 31 banks engaged in middle market lending (47 percent in 1998 and 42 percent in 1997) have eased their underwriting standards for middle market lending. For 1998, examiners reported that two banks (3 percent) tightened their standards. Fifteen banks reportedly eased standards in both 1998 and 1997.

Changes in Underwriting Standards in Middle Market Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	19	75	6
1997	42	55	3
1998	47	50	3

Examiners reported that 90 percent of banks easing middle market underwriting standards granted pricing concessions. Liberalized financial covenant requirements were the second most common method used to ease underwriting in 1998, with 52 percent of the banks employing this method — approximately double the percentage reported in the 1997 survey. Examiners also cited use of guarantor requirements (48 percent), maturities (39 percent), and collateral requirements (29 percent) to relax middle market underwriting standards in 1998.

Banks that eased middle market standards, examiners reported, did so primarily because of competition (94 percent). Changes in the bank's marketing strategy, the next most common reason for easing, was cited by examiners at 19 percent of the banks engaged in middle market lending.

Examiners characterized standards for middle market loans as moderate at 53 percent of the banks, conservative at 41 percent, and liberal at the remaining 6 percent. These percentages are similar to those reported in the 1997 survey.

Changes in the Level of Credit Risk in Middle Market Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	8	64	28	0
1998	0	4	61	35	0
Future 12 Months	0	3	44	52	1

Commercial Real Estate Lending

Sixty-nine of the 77 surveyed banks engaged in commercial real estate lending. Of those banks, examiners reported that 43 percent eased their standards in the last year, compared with 38 percent reported to have done so in the 1997 survey. Only four banks were reported to have tightened standards.

Changes in Underwriting Standards in Commercial Real Estate Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	16	73	11
1997	38	52	10
1998	43	51	6

As with other commercial lending products, 1998 survey results indicate that banks have eased commercial real estate underwriting by combining pricing concessions with structural concessions. This practice differs from 1997, when pricing was the primary method used to ease underwriting standards.

Examiners identified reductions in loan fees and interest rates as methods most frequently used to ease standards (87 percent), up from 75 percent in the last survey. The next most common methods used included easing guarantor requirements (50 percent), extending maturities (43 percent), reducing collateral requirements (37 percent), and relaxing covenants (37 percent).

As was the case in the 1997 survey, examiners cited competition as the primary reason for easing lending standards (93 percent). Examiners also identified changes in market strategy (20 percent) as a reason for easing standards.

Examiners characterized current lending standards for commercial real estate loans as conservative at 48 percent of the surveyed banks, moderate at 46 percent, and liberal at the remaining 6 percent. These findings are similar to the results of the 1997 survey (51 percent conservative, 46 percent moderate, and 3 percent liberal).

Changes in the Level of Credit Risk in Commercial Real Estate Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	12	57	28	3
1998	0	9	59	32	0
Future 12 Months	0	6	51	43	0

Small Business Lending

Sixty-eight of the banks covered by the 1998 survey provide lending to the small business market. Twenty-four percent of these banks eased their standards during the last year, compared with 15 percent in the 1997 survey. Unlike the middle market and syndicated/national credits, where larger banks have actively eased standards, mid-size banks are primarily responsible for easing small business underwriting standards. Examiners also reported that only 4 percent of the banks lending to the small business market tightened their standards in the last year, compared with 16 percent in 1997.

Changes in Underwriting Standards in Small Business Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	13	84	3
1997	15	69	16
1998	24	72	4

As was the case in 1997, survey results indicate that banks most frequently relaxed underwriting standards by reducing fees and spreads (69 percent). Maturities, collateral requirements, and covenants were also used to ease small business underwriting standards.

As in the two previous surveys, examiners reported that banks eased standards primarily because they wanted to remain competitive in the marketplace (81 percent). Examiners also cited market strategies (38 percent) as a reason for easing standards, perhaps because this lending represented a new or growth product for several of the surveyed banks.

Examiners characterized current lending standards for small business loans as moderate at 53 percent of the surveyed banks, conservative at 44 percent, and liberal at the remaining 3 percent. These findings are consistent with 1997 assessments.

Changes in the Level of Credit Risk in Small Business Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	9	70	20	1
1998	0	6	68	25	1
Future 12 Months	0	6	48	46	0

International Lending

In 1998 survey questions were modified to investigate how examiners viewed the impact of the financial crisis in Asia on the international lending activities of the surveyed banks. In this year's survey, examiners were asked to distinguish between their banks' international lending to developed markets and their lending to emerging markets.

Twenty-five of the surveyed banks are engaged in international lending; 23 provide loans to developed markets and 20 to emerging markets.

International lending was the only commercial product with a reported net tightening of underwriting standards in the 1998 survey — an apparent reaction to financial trends in Asia. Examiners at 60 percent of the banks reported tightened standards for emerging markets while only 26 percent of the surveyed banks reportedly tightened standards for developed markets. One bank reportedly eased lending standards for developed and emerging markets. These 1998 results differ dramatically from 1997 results, when 11 banks (34 percent) eased standards and one bank tightened its underwriting criteria.

Changes in Underwriting Standards in International Loan Portfolios*

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	11	89	0
1997	34	63	3
1998	5	53	42

*Includes developed and emerging markets.

The methods surveyed banks used to tighten underwriting standards were similar for both developed and emerging markets. Examiners most frequently cited reducing the size of the credit line and shortening maturities, followed by more stringent collateral requirements, increased pricing, and tighter covenants as the most common methods used to tighten standards. The primary reason for tightening standards was the economic outlook (100 percent for emerging markets and 83 percent for developed markets). Examiners also believed a change in risk appetite or market strategy was responsible for tightened underwriting standards.

Examiner characterizations of the current lending standards of international banks are similar to 1997 survey results. They described the lending standards for developed markets as conservative at 83 percent of the surveyed banks and moderate at the remaining 17 percent. For emerging markets, 80 percent of the banks' standards are considered conservative and the remaining 20 percent are considered moderate. (In 1997 examiners characterized standards for international credits as conservative at 79 percent and moderate at the remaining 21 percent.)

Changes in the Level of Credit Risk in International Loan Portfolios*

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	7	70	23	0
1998	5	9	42	42	2
Future 12 Months	0	9	54	35	2

* Includes developed and emerging markets.

Agricultural Lending

Thirty-nine of the 77 banks in the survey are engaged in some form of agricultural lending. Of the banks in this market, examiners described 18 percent as having eased their lending standards during the last year, an increase from the 8 percent reported in the 1997 survey. Unlike the 1997 survey results, which indicated limited easing of agricultural underwriting standards (confined largely to pricing), 1998 survey results indicate increased easing of standards, including structural criteria. Only 8 percent of the banks reportedly tightened standards, compared with 13 percent in the 1997 survey. This represents a shift from overall tightening of standards in 1997 to overall easing in 1998.

Changes in Underwriting Standards in Agricultural Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	2	95	3
1997	8	79	13
1998	18	74	8

Consistent with the other commercial products, examiners most frequently cited changes in loan fees and interest rates (86 percent) as the method used to change standards. Unlike other commercial products, examiners also identified liberalized collateral requirements (71 percent) as a common way to relax standards. Examiners also reported that agricultural lenders eased guarantor requirements, covenants, and maturities to change underwriting standards in 1998. Despite a decline in the number of banks engaged in agricultural lending, survey results indicate that competitive pressures most often served as the basis for eased standards.

Lending standards for agricultural loans were characterized as conservative at 59 percent of the banks and moderate at 41 percent, a modest shift toward conservative since the 1997 survey.

Changes in the Level of Credit Risk in Agricultural Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	17	66	17	0
1998	0	13	64	23	0
Future 12 Months	0	10	54	36	0

Retail Lending Portfolios

Credit Card Lending

For the 58 surveyed banks that were engaged in credit card lending, including several monoline companies, the 1998 survey results parallel those from 1997 and 1996; that is, the overall level of inherent credit risk continues to increase despite tightening of underwriting standards. Examiners report that 38 percent of the surveyed banks tightened their standards in 1998, compared with 59 percent reported to have tightened standards in 1997. Examiners at 16 banks reported tightening for both of the survey periods.

Changes in Underwriting Standards in Credit Card Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	8	62	30
1997	3	38	59
1998	3	59	38

Examiners cited increased scorecard minimums (64 percent) as the most common technique used to tighten standards. Other methods included increased pricing (50 percent) and reduced credit line size (41 percent). Only two banks were reported to have eased credit card standards. Both made pricing concessions and eased the credit line limits.

According to the examiners, changes in risk appetite (59 percent), market strategy (50 percent), and the competitive environment (41 percent) were the primary reasons the banks had tightened standards. Changes in the economic outlook, which was the leading factor for tightening in 1997, ranked fourth at 36 percent. In addition to tightening standards, examiners reported that some banks exited the credit card business entirely. Additionally, examiners reported that banks continue to reposition their credit card portfolios by selling off portions of portfolios and concentrating their efforts on select markets.

Examiners characterized current standards for credit cards as moderate at 47 percent of the surveyed banks, conservative at 50 percent, and liberal at the remaining 3 percent. This represents a 9 percent shift from moderate and liberal to conservative since 1997.

Changes in the Level of Credit Risk in Credit Card Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997*	1	8	27	47	15
1998	9	15	33	41	2
Future 12 Months	3	17	43	35	2

*NA (not available) responses excluded.

Although many banks had tightened standards for credit cards, examiners again cited other reasons for the increased level of credit risk, primarily trends in consumer delinquencies and bankruptcies.

Home Equity Lending (HEL)

Home equity lending (HEL), which includes both home equity loans and lines of credit, is offered by more of the banks (91 percent) in the survey population than any other product. Growth in home equity portfolios has been strong. Banks have targeted this area for expansion by reaching out to new segments of the market (often offering high loan-to-value or sub-prime products) and by replacing unsecured loan products such as credit cards with home equity products.

Among the 70 banks in the survey that have been engaged in home equity lending, examiners saw a continuing trend toward easing standards. The 1998 survey found easing at 33 percent of HEL lenders, compared with 38 percent in the 1997 survey. Seven percent of the banks tightened standards, representing a slight increase over 1997.

Changes in Underwriting Standards in Home Equity Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	16	81	3
1997	38	58	4
1998	33	60	7

Increased loan-to-value ratios (52 percent), lower fees and interest rates (35 percent), more liberal amortization schedules (30 percent) and increased size of the credit line or loan were most often cited as techniques used to ease underwriting standards for HEL loans. Over 50 percent of the responses indicated banks eased more than one of the underwriting criteria. For banks that tightened HEL standards, examiners reported that banks most commonly increased scorecard cut-offs. This method of tightening standards is typical of other retail products as well.

Examiners continue to identify competition (65 percent) and market strategy (57 percent) as the major reasons for changing HEL lending standards. For the banks in which examiners reported tightened home equity standards, a change in risk appetite precipitated the tightening.

Examiners considered 57 percent of the surveyed banks to have moderate lending standards, with an additional 31 percent described as conservative and 12 percent liberal.

Changes in the Level of Credit Risk in Home Equity Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	3	55	42	0
1998	0	6	61	30	3
Future 12 Months	0	4	57	36	3

Other Direct Consumer Lending

Sixty-nine banks surveyed in 1998 were engaged in direct consumer lending (e.g., personal loans, automobile loans, student loans.) The survey found eased standards for this portfolio at 13 percent of the banks and tightened standards at 22 percent. These percentages are comparable with the results of the 1997 survey (15 percent eased, 26 percent tightened).

Changes in Underwriting Standards in Other Direct Consumer Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	16	69	15
1997	15	59	26
1998	13	65	22

Survey results show that the methods banks used to tighten standards included increasing the cut-off score (47 percent), increasing pricing (27 percent) and decreasing the size of the credit line. For banks that eased their underwriting standards, examiners indicated lower cutoff scores were the most common method (56 percent) used.

Banks that tightened standards most often did so because of a change in their risk appetite (67 percent) or because of a change in their marketing strategy (53 percent). Banks easing standards reportedly did so primarily because of competitive pressures (56 percent).

Examiners characterized standards for direct consumer loans as moderate at 61 percent of the surveyed banks, conservative at 38 percent, and liberal at only one bank (1 percent).

Changes in the Level of Credit Risk in Other Direct Consumer Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997	0	4	60	34	2
1998	1	9	55	35	0
Future 12 Months	2	9	46	43	0

Indirect Consumer Lending

Fifty-six of the banks surveyed in 1998 were engaged in indirect consumer lending. Both large and mid-size banks are equally active in indirect lending and the degree of easing and tightening of underwriting standards is comparable among both groups of banks. Examiners indicated several banks reportedly entered the sub-prime arena as a quid pro quo to maintain access to other aspects of the dealer business. While business activity levels are relatively low, examiners nevertheless reported almost one-half of the surveyed banks are engaged in sub-prime lending.

The survey found that 13 percent of the banks had eased lending standards, while 48 percent had tightened standards. Twenty percent of the banks reportedly tightening their underwriting standards did so in both 1997 and 1998.

Changes in Underwriting Standards in Indirect Consumer Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	21	60	19
1997	16	51	33
1998	13	39	48

Examiners reported that banks employed scorecards (52 percent), collateral requirements (44 percent), and increased pricing (41 percent) to tighten their underwriting standards. Examiners believed that a change in risk appetite (67 percent) and market strategy (48 percent) were primarily responsible for tightened standards. Banks that eased standards, examiners reported, typically lowered cutoff scores, basing their decision on a change in the market strategy.

Examiners characterized current lending standards for indirect consumer credits as moderate at 55 percent of the surveyed banks, conservative at 36 percent, and liberal at the remaining 9 percent. These survey results represent a 14 percent shift from moderate and liberal standards to conservative from the 1997 survey, when examiners characterized 64 percent of standards as moderate, 22 percent as conservative, and 14 percent as liberal.

Changes in the Level of Credit Risk in Indirect Consumer Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997*	2	3	45	42	5
1998	0	21	32	43	4
Future 12 Months	4	20	39	37	0

*NA (not available) responses excluded.

Consumer Leasing

The 1998 survey is the first to include consumer leasing as a separate retail lending product. Although new as a separate survey category, consumer leasing is not a new activity for most of the surveyed banks. (Consumer leasing was primarily reported under the indirect consumer lending category in 1997.) Twenty-four banks offer lease financing to consumers. Most of the consumer leasing is composed of automobile leases.

Seven banks (29 percent) reportedly tightened their consumer leasing underwriting standards, while only one bank eased its standards. Examiners commented that banks tightened underwriting by raising scorecard minimums (71 percent), strengthening collateral requirements (57 percent), and revising pricing or maturities (each at 29 percent). They cited change in market strategy and risk appetite as the primary reasons for the tightening.

Changes in Underwriting Standards in Consumer Leasing Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1998	4	67	29

According to examiners, underwriting standards for consumer leasing are deemed moderate at 58 percent of the surveyed banks and conservative at 42 percent of the banks.

Changes in the Level of Credit Risk in Consumer Leasing Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1998	0	4	38	58	0
Future 12 Months	0	4	38	58	0

Residential Real Estate Lending

Sixty-eight of the surveyed banks were engaged in residential real estate lending. Survey results indicate less adjusting of underwriting standards for residential real estate, including affordable housing, than for any other loan category. Examiners reported underwriting standards were unchanged in 87 percent of the banks, with 9 percent easing and 4 percent tightening. The 1997 survey also found limited underwriting adjustments for this product (83 percent unchanged, 14 percent eased, 3 percent tightened).

Changes in Underwriting Standards in Residential Real Estate Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	5	91	4
1997	14	83	3
1998	9	87	4

The survey indicates that most banks that eased standards did so by increasing the maximum loan size or by relaxing collateral requirements. Examiners identified competitive considerations and changes in market strategy as the primary reasons for easing standards.

Underwriting standards for residential real estate loans are characterized as moderate at 51 percent of the surveyed banks, conservative at 46 percent, and liberal at the remaining 3 percent.

Changes in the Level of Credit Risk in Residential Real Estate Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997*	0	5	73	20	0
1998	1	4	74	18	3
Future 12 Months	0	9	73	18	0

*NA (not available) responses excluded.

Affordable Housing Lending

For the purposes of this survey, affordable housing loans (AHL) included all types of loans on affordable housing for low- and moderate-income individuals and families, including one-to-four family and multifamily dwellings. Fifty-nine banks were reported to be making affordable housing loans. Large and mid-size banks are equally active in providing this type of lending.

Changes in Underwriting Standards in Affordable Housing Loan Portfolios

(Percent of Banks)

	Eased	Unchanged	Tightened
1996	10	82	8
1997	11	74	15
1998	9	86	5

Standards for affordable housing loans have been relatively stable during the previous three years. Most banks (86 percent) made no adjustments to their underwriting standards for affordable housing loans, with only five banks reportedly easing and three banks tightening their standards. Those easing standards adjusted pricing and collateral requirements. Banks tightening standards reportedly strengthened collateral requirements. For banks that eased their underwriting standards, examiners cited competition and market strategy as the primary reasons. For banks that tightened standards, examiners reported a change in risk appetite as being responsible for the change.

Examiners characterized standards for affordable housing loans as moderate at 46 percent of the surveyed banks, conservative at 32 percent, and liberal at the remaining 22 percent.

Changes in the Level of Credit Risk in Affordable Housing Loan Portfolios

(Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1997*	1	4	76	15	3
1998	0	5	78	15	2
Future 12 Months	0	0	76	24	0

*NA (not available) responses excluded.