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OCC Survey Finds Tightened Commercial Loan Standards
For First Time In Five Years, But Credit Risk Remains
High

WASHINGTON -- In its fifth annual Survey of Credit Underwriting Practices, the Office of the Comptroller of the Currency (OCC) reported today that underwriting standards for commercial loans tightened at national banks for the first time in five years, while retail lending standards improved for the third consecutive year.

Despite the tightening, national bank examiners reported that the level of embedded portfolio credit risk continues to increase for every commercial and retail credit product surveyed. This is due to the higher level of risks that banks took on in previous years that takes time to work its way through a loan portfolio. The survey found that examiners expect credit risk to continue to increase over the next year.

"While I am encouraged by the findings of this year's survey," Comptroller of the Currency John D. Hawke, Jr. said in a letter to national banks accompanying the survey, "I remain concerned about the quantity and quality of credit risk among (national) banks. ... For commercial loans, the cumulative effect of the past four years of easing standards is to expose banks to increased risk of loss in the event of default."

Mr. Hawke called on bankers to act now to candidly assess existing and potential vulnerabilities in their portfolios, and to implement appropriate risk management and mitigation strategies. The Comptroller said banks should increase efforts to:

identify the nature and volume of exceptions to their underwriting and risk selection policies and evaluate the extent to which such exceptions indicate higher risk of default or loss in credit portfolios;

increase the supervision of lower rated "pass" credits (loans which are not designated as problem loans), leveraged loans, and other higher risk credits, and stress test performance and collateral valuation assumptions;

identify concentrations and correlations among exposures that may be directly or indirectly vulnerable to economic, industry, or product cycles;

ensure that the capability and capacity of risk management, loan administration, and loan workout functions for poorly performing loans are sufficient to properly identify and manage current and potential portfolio risks; and

ensure that loan loss reserves are adequate to absorb expected losses inherent in the loan portfolio.

The OCC will also continue examination efforts designed to clearly identify and communicate the increased risks associated with loans with structural underwriting weaknesses to bank management and boards of directors. Additionally, the OCC will continue examiner training efforts, commenced last year, to further advance the risk evaluation and classification skills of examiners.

Mr. Hawke said that improvement in underwriting standards reported in this year's survey could be traced to a variety of factors, "including a renewed sensitivity to credit risk among lenders following the credit market turbulence of the fall of 1998, the continued high delinquency and loss rates for many retail lending products, and the efforts of bank regulators to address trends in bank underwriting practices."

The 1999 OCC survey found that:

Examiners at 25 percent of the surveyed banks -- compared with only 4 percent in 1998 -- reported tightened standards for commercial loans. By contrast, 13 percent eased standards in 1999 compared to 44 percent in 1998.

Tightened underwriting standards for commercial loans were most pronounced for international loans, syndicated and national loans and agriculture loans, while examiners reported that standards for commercial real estate and middle market credits continued to ease.

Bankers most often increased pricing to tighten commercial lending standards.

Bankers continued to tighten their standards for most retail loan products with the exception of home equity lending where eased standards prevailed. A large proportion of banks are now engaged in high loan-to-value home equity lending (54 percent of surveyed banks). This in and of itself is indicative of a significant liberalization of standards for home equity lending in general.

David D. Gibbons, OCC Deputy Comptroller for Credit Risk, said that "while the survey results appear to reflect a positive change in risk tolerance of credit providers, it is important to remember that actions taken in the last year will do little to offset the cumulative effect that four years of easing standards for commercial loans has had on risk of loss inherent in bank portfolios."

The 1999 survey covered the 67 largest national banks. All companies in the 1999 survey have assets of more than \$2 billion. The aggregate loan portfolios of the banks in the survey was approximately \$1.8 trillion as of December 31, 1998. This represents 90 percent of all outstanding loans in national banks.

For a copy of the 1999 Survey of Credit Underwriting Practices, write to:
Office of the Comptroller of the Currency, Communications Division, Washington, DC 20219. Copies can also be requested by fax at (202) 874-4448; by phone at (202) 874-5043; or by visiting the OCC's Public Reference Room at 250 E Street, S.W., Washington, DC (9 a.m. - noon and 1 - 3 p.m., Monday - Friday).

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The OCC charters, regulates and examines approximately 2,400 national banks and 60 federal branches and agencies of foreign banks in the United States, accounting for 58 percent of the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.

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