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Acting Comptroller of the Currency Warns of Continued Slide in
Bank Lending Practices

CHICAGO -- Acting Comptroller of the Currency Julie L. Williams said today an agency survey shows that bank lending practices have continued to deteriorate and announced a new series of initiatives aimed at halting the slide in credit standards.

The results of the agency's fourth annual survey of loan underwriting standards are "unsettling," Ms. Williams said, particularly in the area of commercial loans where standards have deteriorated in almost every category.

"More and more lenders are behaving like investors on the downside -- that is accepting greater risk of loss -- with no compensating opportunity to reap the potentially unlimited gains that drive investors," she said in a speech today to a Robert Morris Associates conference here.

"Across the board, banks are granting broader and more generous concessions to business borrowers," she added, citing preliminary results from the OCC's fourth annual survey of bank underwriting practices. "Provisions governing covenants, guarantors and tenors have become less rigorous for borrowers. Collateral requirements have been relaxed."

And even as banks have increased their exposure to risk, they have also reduced their ability to cover potential losses out of existing resources. "Call report data shows a steady drop in the percentage of loan loss reserves to gross loans and leases over the past 22 quarters," she said.

Ms. Williams said she has directed OCC examiners to:

Report to CEOs and Boards of Directors, as appropriate, specific loans identified during the examination process that have structural weaknesses that might jeopardize repayment and/or orderly liquidation of the loans at a future date. The types of structural weaknesses most commonly encountered are inappropriate maturities or amortization schedules, ineffective covenants and inadequate capital or guarantor support.

Comment, in the Report of Examination or other appropriate supervisory communications, on the extent to which a bank's lending practices deviate from its formal underwriting policies and whether the bank recognizes such deviations and has in place a formal system to manage the additional risk that results. In the past, departures from formal lending policies have caused significant problems for banks.

Comment on the volume of, and trends in, loans upon which payment prospects are heavily dependent upon the realization of projected cash flows, asset values, equity values or a borrower's so-called "enterprise value."

Identify any adverse credit risk trends within the category

of credits rated as "pass" by the examiner.

Ms. Williams noted that the steps she announced, which build upon several programs the agency already has in place, are intended to give bankers the opportunity to make appropriate risk management adjustments.

"The deterioration in credit underwriting standards we are seeing in the banking system today is serious," she said. "It could presage the same kinds of problems that afflicted the industry nearly a decade ago. But history does not have to repeat itself. Bankers have the opportunity to take the steps necessary to contain their credit risk going forward. The time for that action is now."

Following the agency's last underwriting survey, which was unveiled in October, 1997, the OCC took a number of steps aimed at correcting problems. Examiners-in-charge discussed the survey with bank senior management, emphasizing findings relevant to each institution, and continued to review credit underwriting standards by sampling new loans and discussing results with bank management.

In addition, the OCC began a system-wide study of the capability of national banks to deal with an increase in the volume of problem loans and accelerated efforts to finalize interagency guidance governing retail credit classification and chargeoff policies. The agency announced that guidance would be issued on loan portfolio management techniques. This guidance, the OCC's Loan Portfolio Management Handbook, was issued in April.

A number of positive responses to the OCC program were evident, including efforts by a number of community banks to revise their loan policies, beef up collection capabilities and develop contingency plans to deal with a decline in asset quality that would result if the economy deteriorates. However, the 1998 survey indicates that the program announced last year has not been fully successful.

"Because banks have not shifted gears to the extent we believe the situation requires, we are shifting gears ourselves to enhance our focus on credit risk issues," Ms. Williams said.

The survey shows that commercial loan standards have slipped in every category except international, where problems in Asia have prompted more conservative practices.

On the retail side, the picture is mixed, she said. Credit card standards improved significantly, but the number of surveyed banks reported to have tightened credit card lending was nearly matched by the number of banks that had eased underwriting standards for loans and credit lines backed by homeowner equity.

Ms. Williams said the easing of standards in home equity lending reflects in part a decision by banks to move into subprime and high loan-to-value (LTV) lending. Both markets, she said, have been plagued by abusive practices and some believe the entry of regulated commercial banks into those areas is the best way to curb the abuses.

"But competitive pressures must not lead to cutthroat, lowest common denominator lending," she said. "If bankers are to become active in these markets, they must be attentive to the peculiar challenges -- both social and financial -- that they pose."

In particular, she said, banks must understand that subprime lending and high LTV loans are separate products that require separate marketing, account management and collections techniques to manage credit exposure.

Banks that treat subprime and high LTV loans as though they were no different from each other and from conventional home equity loans, "are putting their reputations -- as well as their consumer loan portfolios -- at risk."

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The OCC charters, regulates and examines approximately 2,600 national banks and 66 federal branches of foreign banks in the U.S., accounting for more than 58 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.