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Acting Comptroller Williams Provides Details of Deteriorating
Bank Credit Practices

WASHINGTON, D.C. -- Acting Comptroller of the Currency Julie L. Williams provided new and detailed examples today of the kinds of poorly-underwritten loans that have led the OCC to warn that banks need to tighten loan underwriting standards.

"As we see other nation's economies bobbing in turbulent waters, it is doubly important that, here in the United States, bankers address and correct any weaknesses in their loan underwriting, mindful of the possibility that our own economic seas could also turn stormy," she said in a [speech](#) to a meeting of the Bankers Roundtable.

"Taking care now," she emphasized, "is important to the future of each of your banks -- and to the health of the nation's economy."

The OCC has been warning for more than two years now of slippage in loan underwriting standards. Ms. Williams said she was providing detailed examples of poorly underwritten loans because industry representatives suggested, following a July 13 speech on sliding credit practices, that specific examples of such loans would be effective in helping to reverse that trend.

Reacting to those suggestions, Ms. Williams assembled a team of highly-experienced credit analysts to review loans at larger banks and identify those that cause concern.

"We call loans with fundamental structural weaknesses ugly loans," she said. "And that is why, around the OCC, this exercise has come to be known as the Ugly Loan project."

Among the examples Ms. Williams cited was a company with zero working capital, negative net worth and over \$50 million in operating losses last year that was nonetheless able to obtain a new line of revolving credit and a term loan from a national bank that together total almost \$500 million.

"One would think that this kind of borrower would be paying a stiff premium for this credit, if it could find loans at all," Ms. Williams said. "But the contracted price was LIBOR + 150 basis points, currently 7.2 percent."

Moreover, she said, the loan terms require that the borrower pay interest only during the first four years, with graduated repayment of principal starting in year five. This same borrower, she said, sold subordinated debentures with similar maturities in 1996 and paid as much as 14 percent -- junk bond rates.

Ms. Williams said banks should take immediate steps to deal with

poorly structured loans on their books, including the following:

Increase the scope and frequency of loan reviews as a critical part of a bank's credit risk process;

Augment workout staffs and involve workout experts in loan monitoring efforts;

Periodically reassess their strategic portfolio objectives and risk tolerance limits; and

Carefully examine the adequacy of capital and loan loss reserves in light of credit risk ratings. A bank that has eased its underwriting standards should adjust its loan loss allowance to reflect the likelihood of increased credit losses.

The OCC, she said, will maintain the highest levels of supervisory vigilance. Within the next two weeks, the agency will implement a number of changes in its examination procedures that were announced in July, including the establishment of a special on-line system to capture data from examination reports. The new system will make it possible to track lending trends with much greater specificity than in the past.

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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.