To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, and Foreign Bank Offices
in the Twelfth Federal Reserve District

Credit Quality of the Shared National Credit Portfolio Improved in 2010

The credit quality of large loan commitments owned by U.S. bank organizations, foreign bank organizations (FBOs), and nonbanks remained weak in 2010, but improved from 2009, according to the Shared National Credits (SNCs) Review for 2010.

Although 18 percent of all SNCs were criticized, the volume of criticized loans decreased more than 30 percent from record levels reported in 2009. The severity of classifications also improved, with $15 billion classified as loss, compared with $53 billion in 2009. A loan commitment is the obligation of a lender to make loans or issue letters of credit pursuant to a formal loan agreement.

Reasons for improvement included improved borrower operating performance, debt restructurings and bankruptcy resolutions, and improved borrower access to bond and equity markets. Industries contributing to improvement in credit quality included automotive, materials and commodities, and finance and insurance. The volume of poorly underwritten credits originated in 2006 and 2007 continued to adversely affect the overall credit quality of the portfolio. Refinancing risk within the portfolio is significant, with nearly 67 percent of criticized assets maturing between 2012 and 2014.

While nonbank entities, such as securitization pools, hedge funds, insurance companies, and pension funds, owned the smallest share of commitments, they owned the largest volume and percentage in dollar value of classified credits at $161 billion, or 52.9 percent of classified credits.

Other findings include (definitions used in the report can be found on page 4):

- Total SNC commitments fell $362 billion to $2.5 trillion, a 12.6 percent decline. Total SNC loans outstanding fell $352 billion to $1.2 trillion, a decline of 22.5 percent.
- Criticized assets, which include assets rated special mention, substandard, doubtful, and loss, declined to $448 billion from $642 billion and represented 17.8 percent of the SNC portfolio, compared with 22.3 percent in 2009.
- Classified assets, which include assets rated substandard, doubtful, and loss, declined to $305 billion from $447 billion in 2009 and represented 12.1 percent of the portfolio, compared with 15.5 percent in 2009. Classified dollar volume fell 31.8 percent from 2009 levels.
- Credits rated special mention, which exhibited potential weakness and could result in further deterioration if uncorrected, declined to $143 billion from $195 billion and represented 5.7 percent of the portfolio, compared with 6.8 percent in 2009.
- The severity of classifications improved, with the volume of credits classified as doubtful and loss decreasing to $48 billion from $110 billion, a 56.4 percent decline. Nonaccrual loans declined to $151 billion from $172 billion. Adjusted for losses, nonaccrual loans declined from $140 billion to $136 billion.
- The distribution of credits across entity types—U.S. bank organizations, FBOs, and nonbanks—remained relatively unchanged. U.S. bank organizations owned 40.8 percent, FBOs owned 37.9 percent, and nonbanks owned 21.3 percent of total SNC loan commitments. Nonbanks continued to own a disproportionate share of classified (52.9 percent) and nonaccrual (57.8 percent) assets compared with their total share of the SNC portfolio (21.3 percent). Federal Deposit Insurance Corporation-insured institutions owned only 22.7 percent of classified assets and 18.1 percent of nonaccrual loans.
The media and telecommunications industry group led other industries in criticized volume with $94 billion. Real estate and construction followed with $60 billion, then finance and insurance with $49 billion. These three industries represented the highest shares of criticized credits, with 21.1 percent, 13.5 percent, and 11.0 percent of criticized credits in the portfolio.

Although improved, the dollar volume of criticized leveraged-finance loans remained high, with 62 percent of credits extended to the 50 largest leveraged borrowers criticized.

SNC originations declined in 2009 compared with the previous two years, and the small number of new loans made it difficult to draw meaningful conclusions about the quality of new underwriting. The portfolio contained a large volume of loans committed to before mid-2007 that continued to adversely affect the overall quality of the portfolio.

The SNC program was established in 1977 to provide an efficient and consistent review and classification of SNCs, which includes any loan or formal loan commitment, and any asset such as real estate, stocks, notes, bonds, and debentures taken as debts previously contracted, extended to borrowers by a federally supervised institution, its subsidiaries, and affiliates that aggregates to $20 million or more and is shared by three or more unaffiliated supervised institutions. Many of these loan commitments are also shared with FBOs and nonbanks, including securitization pools, hedge funds, insurance companies, and pension funds.

In conducting the 2010 SNC Review, agencies reviewed $1.0 trillion of the $2.5 trillion credit commitments in the portfolio. The sample was heavily weighted toward non-investment grade and criticized credits. The results of the review are based on analyses prepared in the second quarter of 2010 using credit-related data provided by federally supervised institutions as of December 31, 2009, and March 31, 2010.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco’s website, at http://www.frbsf.org/banking/letters.

For additional information, please contact:

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Attachments:  Shared National Credits Program 2010 Review

Industry Definition Outline