Federal Reserve Bank of San Francisco
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To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, Savings and Loan Holding Companies,
and Foreign Banking Offices
in the Twelfth Federal Reserve District

Credit Risk in the Shared National Credit Portfolio Declines, but Remains High

The credit quality of large loan commitments owned by U.S. banking organizations, foreign banking organizations (FBOs), and nonbanks improved in 2012 for the third consecutive year, according to the Shared National Credits (SNC) Review for 2012. A loan commitment is the obligation of a lender to make loans or issue letters of credit pursuant to a formal loan agreement.

The volume of criticized loans remained high at $295 billion compared with levels before the financial crisis, but declined 8.1 percent from 2011. A criticized loan is rated special mention, substandard, doubtful, or loss.

Reasons for improvement in credit quality included better operating performance among borrowers, debt restructurings, bankruptcy resolutions, and ongoing access to bond and equity markets.

Despite this progress, poorly underwritten loans originated in 2006 and 2007 continued to adversely affect the SNC portfolio. While the overall quality of underwriting of SNCs that were originated in 2011 was significantly better than in 2007, some easing of standards was noted, specifically in leveraged finance credits, especially compared with the relatively tighter standards present in 2009 and the latter half of 2008. Refinancing risk eased during the past year as 37.1 percent of SNCs will mature over the next three years compared with 63.4 percent for the same time frame in the 2011 SNC Review.

The federal banking agencies expect banks and thrifts to originate syndicated loans using prudential underwriting standards, regardless of their intent to hold or sell them. SNCs that are poorly underwritten will be subject to regulatory criticism or classification during annual SNC reviews. The federal banking agencies expect to finalize revised guidance on leveraged lending to form the basis of the agencies' supervisory focus and review of supervised financial institutions involved in leveraged lending.

Although nonbank entities, such as securitization pools, hedge funds, insurance companies, and pension funds, owned the smallest share of loan commitments, they owned the largest share (62.4 percent) of classified credits (rated substandard, doubtful, or loss).

In other highlights of the review:

- Total SNC commitments increased 10.6 percent from the 2011 review to $2.79 trillion. Total SNC loans outstanding increased $125 billion to $1.24 trillion, an increase of 11.2 percent.
- Criticized assets represented 10.6 percent of the SNC portfolio, compared with 12.7 percent in 2011.
- Classified assets declined 8.8 percent to $196 billion in 2012 and represented 7 percent of the portfolio, compared with 8.5 percent in 2011.
- Credits rated special mention, which exhibited potential weakness and could result in further deterioration if uncorrected, was largely unchanged at $99 billion in 2012, representing 3.6 percent of the portfolio.

- Adjusted for losses, nonaccrual loans declined to $81 billion from $91 billion, an 11.1 percent reduction.
- The distribution of credits across entities--U.S. banking organizations, FBOs, and nonbanks--remained relatively unchanged. U.S. banking organizations owned 43.2 percent of total SNC loan commitments, FBOs owned 36.9 percent, and nonbanks owned 19.8 percent. The share owned by nonbanks declined for the second consecutive year. Nonbanks continued to own a larger share of classified (62.4 percent) and nonaccrual (66.4 percent) assets compared with their total share of the SNC portfolio. Institutions insured by the Federal Deposit Insurance Corporation owned 13.4 percent of classified assets and 9.5 percent of nonaccrual loans.
- The media and telecommunications industry group led other industry groups in criticized volume with $66 billion. Finance and insurance followed with $34 billion, then utilities with $30 billion. Although these groups had the largest dollar volume of criticized loans, the three groups with the highest percentage of criticized loans were entertainment and recreation (28.3 percent), media and telecommunications (24.6 percent), and transportation services (22.7 percent). Each of these industry groups saw declines in the share of criticized loans from a year ago.

The SNC program was established in 1977 to provide an efficient and consistent review and analysis of SNCs. A SNC is 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 2012 SNC Review, agencies reviewed $811 billion of the $2.79 trillion credit commitments in the portfolio. The sample was weighted toward noninvestment grade and criticized credits. The results of the review are based on analyses prepared in the second quarter of 2012 using credit-related data provided by federally supervised institutions as of December 31, 2011, and March 31, 2012.

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 2012 Review (PDF)*
Industry Mapping File (PDF)