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RISK IN UNDERWRITING PRACTICES REMAINS A CONCERN, FDIC REPORT SAYS

FOR IMMEDIATE RELEASE

The occurrence of risky underwriting practices for construction, commercial (nonresidential) real estate, and home equity lending by banks has increased slightly in recent months, according to the FDIC's latest Report on Underwriting Practices, which covers the six months ending September 30, 2000. While the frequency of risky underwriting practices in these loan categories has not reached highs from two years ago, FDIC officials said the situation remains a concern.

The risks associated with current underwriting practices, loan growth, and credit risk in banks' loan portfolios also have increased in recent months. In contrast, the occurrence of risky underwriting practices for agriculture lending decreased somewhat.

The FDIC's report on loan underwriting practices, which was started in early 1995, is one of a number of agency initiatives aimed at providing early warnings of potential problems in the banking system. In addition, the information gathered during examinations helps the FDIC target future examiner resources and identify potential weaknesses in underwriting practices that will draw additional attention during on-site examinations.

These are among the key findings of the report indicating continued high levels of risk:

- Twenty-six percent of the active construction lenders were making speculative construction loans (that is, projects unaccompanied by refinancing commitments) "frequently enough to warrant notice" or "commonly or as standard procedure," up from 25 percent previously;

- Eighteen percent of active commercial real estate lenders were frequently or commonly making short-term loans with minimal amortization terms and large "balloon" payments at maturity, up from 17 percent previously; and

- Thirteen percent of active home equity lenders were frequently or commonly making loans that pushed mortgage indebtedness above 90 percent of collateral value, up from 12 percent of such lenders previously.

In terms of banks considered by examiners to have "high" risk in key areas, the report found that five percent had high risk in current underwriting practices (up from three percent previously), and five percent had high risk in their current loan portfolios (also up from three percent). Both of these proportions are the highest since the FDIC began using this measure of risk two years ago. Also, the proportion of banks having high risk associated with loan growth and/or significant changes in lending activities since the previous examination jumped to a record five percent, up from two percent previously.

For FDIC-supervised banks active in agricultural lending, however, examiners reported a decline in the proportion having a "moderate" or a "sharp" increase in the bank's level of "carryover debt" (loans not paid off at the end of the growing season) for the second consecutive six-month period. This improvement may reflect laws enacted to assist farmers in both 1998 and 1999.

The most recent FDIC Report on Underwriting Practices summarizes responses from FDIC examiners to survey questions regarding the lending practices at 1,124 FDIC-supervised banks examined during the six months ending September 30, 2000. For the report, examiners give a general assessment of each bank's underwriting practices overall, as well as for major loan categories.