PRESS RELEASE

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SOME RISKY UNDERWRITING PRACTICES RISE AT BANKS BUT GENERAL UNDERWRITING RISKS SHOW A SLIGHT DECLINE, FDIC REPORT SAYS

FDIC examiners have reported an increase in the occurrence of risky underwriting practices by banks in both construction and consumer lending but found that the percentage of banks in the high-risk categories for general underwriting practices declined slightly, according to the agency's latest *Report on Underwriting Practices*, which covers the six months ending March 31, 2001.

While the frequency of risky practices in construction and consumer lending has not reached the high levels reported three years ago, FDIC officials said the situation remains a concern. Examiners reported less frequent occurrences of risky underwriting practices in the remaining major loan categories covered in the report. For general underwriting practices, examiners noted slight decreases in the risks and also somewhat less frequent occurrences of most risky underwriting practices.

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 at FDIC-supervised banks helps the FDIC target future examiner resources and identify potential weaknesses in underwriting practices that will draw additional attention during on-site examinations.

In the latest report, examiners noted increases in risky underwriting practices involving speculative construction loans, or those construction projects without meaningful pre-sale or pre-lease agreements or commitments for permanent financing. The report found that:

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. It promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars — insured financial institutions fund its operations.

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- 29 percent of the FDIC-supervised banks active in construction lending either "frequently enough to warrant notice" or "commonly or as standard procedure" made speculative construction loans, up from 26 percent from the report covering the six-month period that ended September 30, 2000;
- 17 percent of the active construction lenders frequently or commonly funded or deferred interest payments during the term of the loan, up from 15 percent previously; and
- 13 percent frequently or commonly funded 100 percent of the cost of construction and land, with no cash equity on the part of the borrower or developer, up slightly from 12 percent in the last report.

For FDIC-supervised banks active in consumer lending, the report found that 20 percent frequently or commonly made loans to borrowers who lack a demonstrable ability to repay, up from 18 percent. Also, 15 percent frequently or commonly made secured loans without adequate collateral protection, up slightly from 14 percent.

However, examiners reported positive developments in terms of banks considered to have "high" risk in underwriting practices on the whole. Four percent of the banks had high risk in current underwriting practices (that is, all activities associated with making loans), down slightly from five percent previously. Four percent had high risk in their current loan portfolios (loans already made), also down slightly from five percent. Also, the proportion of banks having high risk associated with loan growth and/or significant changes in lending activities since the previous examination fell to three percent from a record five percent previously.

The most recent FDIC *Report on Underwriting Practices* summarizes responses from FDIC examiners to survey questions regarding the lending practices at 1,181 FDIC-supervised banks examined during the six months ending March 31, 2001. For the report, examiners give a general assessment of each bank's underwriting practices overall, as well as for major loan categories.