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RISKS IN BANKS' LOAN PORTFOLIOS AND LOAN ADMINISTRATION HAVE INCREASED SLIGHTLY, FDIC REPORT SAYS

FDIC examiners have reported increases in risks in banks' loan portfolios and in the way loans are administered, according to the agency's latest *Report on Underwriting Practices*, which covers the six months ending September 30, 2001. The risks associated with current underwriting practices and loan growth also edged up in recent months. In most major loan categories, though, the frequency of risky underwriting practices changed very little, except for agricultural lending, where increases were larger. While the increases in risks were slight, FDIC officials said the situation should be monitored, particularly with agricultural lending.

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.

Key findings of the latest reports showed that:

- Six percent of the FDIC-supervised banks had high credit risk in their overall loan portfolios, up from 4 percent in the previous report covering the six-month period that ended March 31, 2001.

- 34 percent had medium risk in the risk associated with loan administration -- typically the supervision and management of the loan process, including verifying information in applications and monitoring loan payments -- up from 31 percent previously. The proportion with high risk remained the same at 6 percent.

- Five percent had high risk in current underwriting practices, up from 4 percent previously.

- 15 percent of FDIC-supervised banks active in agricultural lending either "frequently enough to warrant notice" or "commonly or as standard procedure" made agricultural loans on the basis of land values that cannot be supported by farming, up from 10 percent previously.

- 15 percent either "frequently or "commonly" made agricultural loans on the basis of unrealistic cash flow projections, up from 11 percent previously.

- 23 percent of the active farm lenders showed 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 -- up from 21 percent previously.

In contrast, the latest report included slight decreases or no change in the proportions of banks in the following categories:

- Construction lenders that either "frequently or "commonly" made speculative construction loans dipped from 29 percent to 28 percent.

- Commercial real estate lenders that frequently or commonly made short-term commercial real estate loans with minimal amortization terms and large "balloon" payments at maturity edged down from 15 percent to 14 percent.

- Consumer lenders that frequently or commonly made loans to borrowers who lacked a demonstrable ability to repay remained the same, at 20 percent.

The most recent FDIC *Report on Underwriting Practices* summarizes responses from FDIC examiners to survey questions regarding the lending practices at 1,211 FDIC-supervised banks examined during the six months ending September 30, 2001. For the report, examiners give a general assessment of each bank's underwriting practices overall, as well as for major loan categories.