PRESS RELEASE

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RISKS IN BANKS' UNDERWRITING PRACTICES, LOAN PORTFOLIOS AND LOAN ADMINISTRATION CONTINUE TO INCREASE SLIGHTLY, FDIC REPORT SAYS

FDIC examiners continue to report slight increases in risks in FDIC-supervised banks' underwriting practices, 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 March 31, 2002. In addition, increases in the frequency of risky underwriting practices in two categories -- in construction lending and commercial (nonresidential) real estate lending -- were noteworthy. In general, however, the frequency of risky practices in all major lending categories rose slightly.

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.

As of March 2002, the risks in banks' underwriting practices, loan portfolios and loan administration showed notable increases over those reported at the start of the current recession in March 2001. Key findings of the latest six-month report were:

- Six percent of the FDIC-supervised banks had high risk associated with current underwriting practices, up from five percent in the previous report covering the six-month period that ended September 30, 2001. The proportion of banks with medium risk increased from 32 percent to 34 percent.

- 34 percent had medium risk in their overall loan portfolios, up from 32 percent. The proportion with high risk remained the same at six percent.

- 36 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 34 percent previously. The proportion with high risk remained the same at six percent.

The latest report also shows that the proportion of construction lenders that either "frequently or "commonly" funded, or deferred, interest payments during the term of their construction loans increased from 15 percent to 20 percent. Also, the proportion of commercial (nonresidential) real estate lenders that frequently or commonly made short-term commercial real estate loans with minimal amortization terms and large "balloon" payments at maturity rose from 14 percent to 18 percent. Increases in these two underwriting practices may indicate that banks are holding construction loans longer because demand is slowing as prospective tenants delay occupancy.

In addition, the latest report included slight increases in the proportion of: business lenders that either frequently or commonly made loans to borrowers who lacked documented financial strength to support such lending; consumer lenders that frequently or commonly made loans to borrowers who lacked a demonstrable ability to repay; and agricultural banks with a "moderate" or a "sharp" increase in the level of carryover debt (loans not paid off at the end of the growing season).

The most recent FDIC *Report on Underwriting Practices* summarizes responses from FDIC examiners to survey questions regarding the lending practices at 1,149 FDIC-supervised banks examined during the six months ending March 31, 2002. For the report, examiners give a general assessment of each bank's underwriting practices overall, as well as for major loan categories.