Joint Release	**Federal Deposit Insurance Corporation** **Federal Reserve Board of Governors** **Office of the Comptroller of the Currency**

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Credit Risk in the Shared National Credit Portfolio is High; Leveraged Lending Remains a Concern

The credit quality of large loan commitments owned by U.S. banking organizations, foreign banking organizations (FBOs), and nonbanks is generally unchanged in 2014 from the prior year, federal banking agencies said Friday. In a supplemental report, the agencies highlighted findings specific to leveraged lending, including serious deficiencies in underwriting standards and risk management of leveraged loans.

The annual Shared National Credits (SNC) review found that the volume of criticized assets remained elevated at $340.8 billion, or 10.1 percent of total commitments, which approximately is double pre-crisis levels. The stagnation in credit quality follows three consecutive years of improvements. A criticized asset is rated special mention, substandard, doubtful, or loss as defined by the agencies' uniform loan classification standards. The SNC review was completed by the Federal Reserve Board, Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency.

Leveraged loans as reported by agent banks totaled $767 billion, or 22.6 percent of the 2014 SNC portfolio and accounted for $254.7 billion, or 74.7 percent, of criticized SNC assets. Material weaknesses in the underwriting and risk management of leveraged loans were observed, and 33.2 percent of leveraged loans were criticized by the agencies.

The leveraged loan supplement also identifies several areas where institutions need to strengthen compliance with the March 2013 guidance, including provisions addressing borrower repayment capacity, leverage, underwriting, and enterprise valuation. In addition, examiners noted risk-management weaknesses at several institutions engaged in leveraged lending including lack of adequate support for enterprise valuations and reliance on dated valuations, weaknesses in credit analysis, and overreliance on sponsor's projections.

Federal banking regulations require institutions to employ safe and sound practices when engaging in commercial lending activities, including leveraged lending. As a result of the SNC exam, the agencies will increase the frequency of leveraged lending reviews to ensure the level of risk is identified and managed.

In response to questions, the agencies also are releasing answers to FAQs on the guidance. The questions cover expectations when defining leveraged loans, supervisory expectations on the origination of non-pass leveraged loans, and other topics. The FAQ document is intended to advance industry and examiner understanding of the guidance, and promote consistent application in policy formulation, implementation, and regulatory supervisory assessments.

Other highlights of the 2014 SNC review:

- Total SNC commitments increased by $379 billion to $3.39 trillion, or 12.6 percent from the 2013 review. Total SNC outstanding increased $206 billion to $1.57trillion, an increase of 15.2 percent.

- Criticized assets increased from $302 billion to $341 billion, representing 10.1 percent of the SNC portfolio, compared with 10.0 percent in 2013. Criticized dollar volume increased 12.9 percent from the 2013 level.

- Leveraged loans comprised 72.9 percent of SNC loans rated special mention, 75.3 percent of all substandard loans, 81.6 percent of all doubtful loans, and 83.9 percent of all nonaccrual loans.

- Classified assets increased from $187 billion to $191 billion, representing 5.6 percent of the portfolio, compared with 6.2 percent in 2013. Classified dollar volume increased 2.1 percent from 2013.

- Credits rated special mention, which exhibit potential weakness and could result in further deterioration if uncorrected, increased from $115 billion to $149 billion, representing 4.4 percent of the portfolio, compared with 3.8 percent in 2013. Special mention dollar volume increased 29.6 percent from the 2013 level.

- The overall severity of classifications declined, with credits rated as doubtful decreasing from $14.5 billion to $11.8 billion and assets rated as loss decreasing slightly from $8 billion to $7.8 billion. Loans that were rated either doubtful or loss account for 0.6 percent of the portfolio, compared with 0.7 percent in the prior review. Adjusted for losses, nonaccrual loans declined from $61 billion to $43billion, a 27.8percent reduction.

- The distribution of credits across entity types—U.S. bank organizations, FBOs, and nonbanks—remained relatively unchanged. U.S. bank organizations owned 44.1 percent of total SNC loan commitments, FBOs owned 33.5 percent, and nonbanks owned 22.4 percent. Nonbanks continued to own a larger share of classified (73.6 percent) and nonaccrual (76.7 percent) assets than their total share of the SNC portfolio (22.4 percent). Institutions insured by the FDIC owned 10.1percent of classified assets and 6.7 percent of nonaccrual loans.

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 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 $20 million or more and is shared by three or more unaffiliated supervised institutions. Many of these loan commitments also are participated with FBOs and nonbanks, including securitization pools, hedge funds, insurance companies, and pension funds.

In conducting the 2014 SNC Review, the agencies reviewed $975 billion of the $3.39 trillion credit commitments in the portfolio. The sample was weighted toward noninvestment grade and criticized credits. In preparing the leveraged loan supplement, the agencies reviewed $623 billion in commitments or 63.9 percent of leveraged borrowers, representing 81 percent of all leveraged loans by dollar commitments. The results of the review and supplement are based on analyses prepared in the second quarter of 2014 using credit-related data provided by federally supervised institutions as of December 31, 2013, and March 31, 2014.

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Attachments:

- SNC Review - PDF (PDF Help)
- Leveraged Lending Supplement - PDF (PDF Help)
- Leveraged Lending FAQ - PDF (PDF Help)

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