Shared National Credit Program

1st and 3rd Quarter 2018 Examinations

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Washington, D.C.

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About the Shared National Credit (SNC) Program

The SNC Program is an interagency review and assessment of risk in the largest and most complex credits shared by multiple regulated financial institutions. The SNC Program is governed by an interagency agreement among the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the agencies).

The program began in 1977 to review credits with minimum aggregate loan commitments totaling $20 million or more that were shared by two or more regulated financial intuitions. A program modification in 1988 increased the minimum number of regulated financial institutions from two to three. To adjust for inflation and changes in average loan size, the agencies increased the minimum aggregate loan commitment threshold from $20 million to $100 million effective January 1, 2018.

SNC reviews are completed in the first and third quarters of the calendar year. Large agent banks receive two reviews each year while most other agent banks receive a single review each year. The results discussed in this document are based on examinations conducted in the first and third quarters of 2018 and cover loan commitments originated by or before March 31, 2018. Trends and exhibits shown in the report include data submitted by all reporting banks. Although some banks are examined twice a year, the agencies will continue to issue a single statement annually that captures combined findings from the previous 12 months. The next statement will be released upon completion of the third quarter 2019 SNC examination.

Summary of Results

The level of loans in the SNC portfolio with the lowest supervisory ratings (special mention and classified[1]) declined, largely because of improving economic conditions in the oil and gas sectors. Despite the improvement, special mention and classified commitment levels remain elevated compared to prior economic cycles (see exhibit 3). A significant portion of the special mention and classified commitments are concentrated in transactions that agent banks identified as leveraged loans.

Leveraged Lending

Risks associated with leveraged lending activities are building in contrast to the portfolio overall. Leveraged loans with supervisory ratings below pass typically reflect borrowers with higher than average leverage levels and weaker repayment capabilities. The SNC review found that many leveraged loan transactions possess weakened transaction structures and increased reliance upon revenue growth or anticipated cost savings and synergies to support borrower repayment capacity. Borrowers possess greater control over lending relationships, and market dynamics are changing. Non-bank entities have increased their participation in the leveraged lending market via both purchases of loans and/or direct underwriting and syndication of exposure. More leveraged lending risk is being transferred to these non-bank entities.

The agencies remain focused on assessing the impact of these layered risks. A material downturn in the economy could result in a significant increase in classified exposures and higher losses. Banks engaged in originating and participating in leveraged loans should ensure that risk management processes keep pace with changes in the leverage lending market and ensure that their risk management processes and limits fully consider the potential direct and indirect risks associated with these loans.

Agent banks risk management and underwriting practices have improved in some respects since 2013. Agent banks are better equipped to assess borrower repayment capacity and enterprise valuations, and have

[1] Special mention and classified commitments are defined in appendix A.

developed other risk management processes that better align with safety and soundness principles. Despite the past progress, bank risk management needs to continually evolve as market conditions change and risk layering practices emerge.

The agencies expect lenders to understand and reasonably support the borrowers' ability to achieve revenue growth or anticipated cost savings and synergies when underwriting and risk rating these credit facilities. Lenders should ensure that planned and permissible incremental facility use is fully incorporated into measures that control origination and participation activities. Usage of incremental facilities shortly after funding may materially alter repayment capacity estimates and could adversely affect facility risk ratings. Agent banks and investors should also ensure that stress testing models account for market changes as recovery rates may differ from historical experience. In addition, banks should consider how the potential risks from a downturn in the leveraged lending market may affect other customers and borrowers.

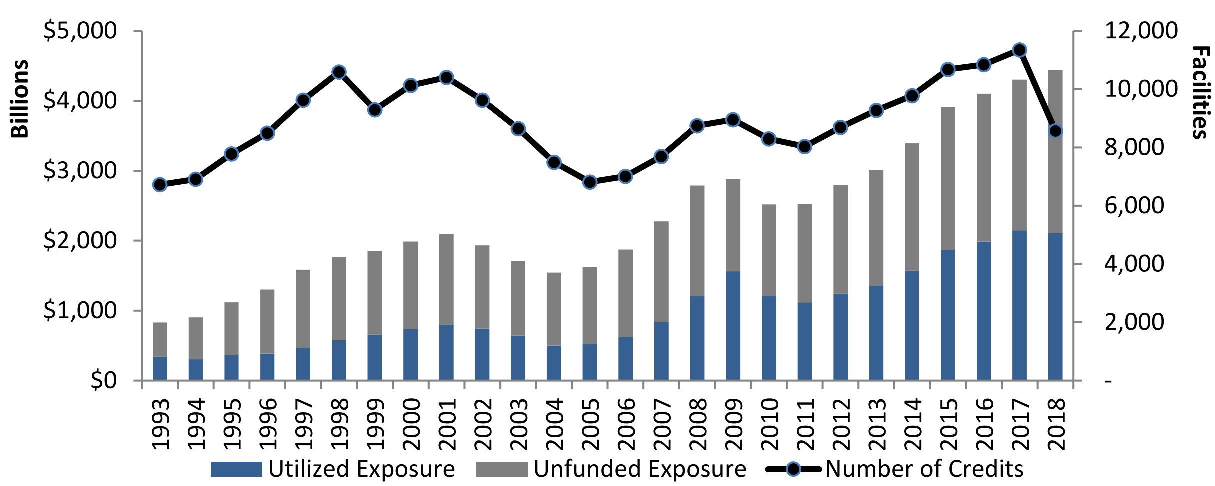
SNC Portfolio: Volume, Credit Quality, and Trends

Overall SNC Portfolio

The 2018 SNC portfolio had $4.4 trillion in total commitments. Total commitments have increased 3 percent, but the number of credit facilities declined from 11,350 in 2017 to 8,571 (see exhibit 1). The number of SNC borrowers declined from 6,902 to 5,314 (see exhibit 2). The decline in borrowers and credit facilities is mostly caused by the minimum commitment threshold increase to $100 million that was effective January 1, 2018. While the increase in the minimum commitment threshold reduced the number of borrowers and credit facilities identified as SNCs, the change had an immaterial effect on total commitments and asset quality measures.

Asset quality measures and trends in the composition of SNC commitments by major industry groups[2] is provided in appendix C.

Exhibit 1: Overall Credit Facilities and Commitment Trends



Decline in SNC facilities mainly reflects the minimum commitment increase from $20 million to $100 million.

[2] The agencies introduced industry data in 2008 that presented industries vertically along product origination and distribution lines. The review places credits in seven primary sectors, largely following the outline of the 2007 U.S. Census Bureau North American Industry Classification System codes (see appendix C).

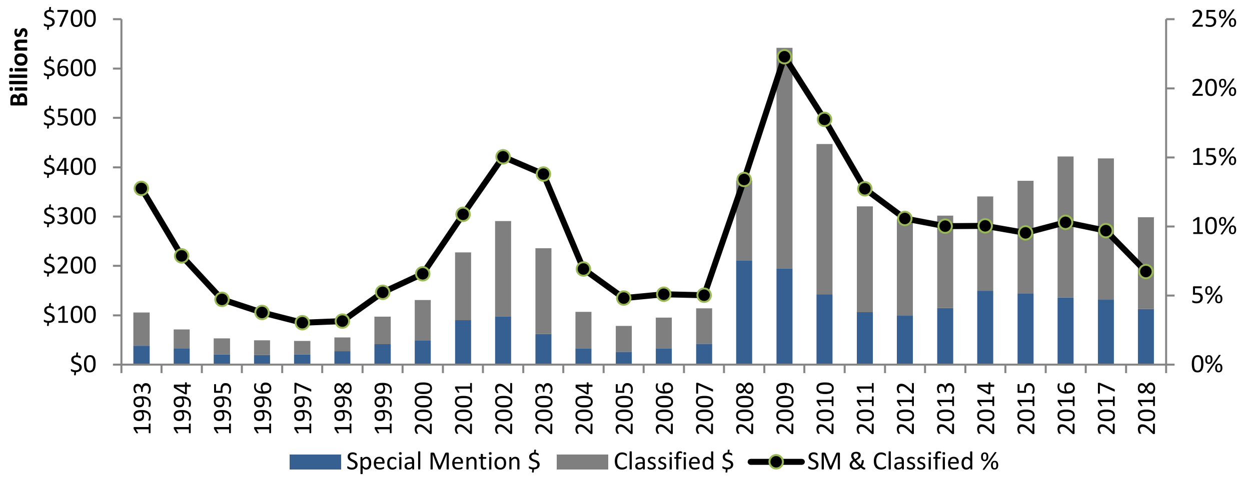
Exhibit 2 Overall SNC Commitment Amounts

	2017 Commitments ($Billions)	2018 Commitments ($Billions)	2018 vs. 2017 ($Billions)	2018 vs. 2017 (%)
SNC Portfolio Commitments	$4,303.7	$4,434.5	$130.8	3.0%
SNC Portfolio Outstanding	$2,149.4	$2,106.0	($43.4)	(2.0%)
SNC Portfolio Borrowers	6,902	5,314	(1,588)	(23.0%)
SM and Classified Commitments	$417.6	$294.9	($122.7)	(29.4%)
SM Commitments	$131.7	$112.4	($19.3)	(14.6%)
Classified Commitments	$285.9	$182.5	($103.4)	(36.2%)
Non-Accrual Commitments	$58.0	$35.8	($22.2)	(38.2%)

Note: Nonaccrual amounts are net of loss dispositions.
Decline in SNC borrowers mainly reflects the minimum commitment increase from $20 million to $100 million

Exhibit 3 shows trends in overall special mention plus classified volume as a percentage of total commitments. The higher volume of special mention and classified commitments beginning in 2008 illustrates the potential risks associated with leveraged lending. As previously disclosed, asset quality measures were adversely affected in 2016 and 2017 by borrowers exposed to the oil and gas sectors, with the subsequent improvement mainly because of more favorable economic conditions in those sectors. This exhibit also illustrates that special mention and classified levels remain moderately higher than in prior economic cycles.

Exhibit 3: Overall Special Mention and Classified Volume and Percentage Trends



Leveraged Lending

Leveraged lending is the primary contributor to the special mention and classified rate of 6.7 percent. Leveraged loans account for 72.8 percent of special mention commitments, 87.0 percent of substandard commitments, 44.8 percent of doubtful commitments, and 76.3 percent of nonaccrual loans.

Given the asset quality and growth observed in this segment, SNC examination samples continued to emphasize a review of these exposures. SNC samples of agent-identified leveraged borrowers increased from 27.2 percent in 2017 to 37.6 percent in 2018, with the review of leverage lending commitments increasing from 34.9 percent in 2017 to 46.3 percent in 2018 (see exhibit 4).

Exhibit 4: SNC Leveraged Lending Exposure and Review Sample

	2017 SNC Examination ($Billions)	2018 SNC Examination ($Billions)	2018 vs. 2017 ($Billions)
SNC Leveraged Lending Commitments	$1,763.1	$2,089.9	$326.8
Sampled SNC Leveraged Lending Commitments	$615.2	$967.8	$352.6
SNC Leveraged Lending Obligors	2,196	2,152	(44)
Sampled SNC Leveraged Lending Obligors	597	809	212

SNC Portfolio: Ownership of Risk

U.S. banks continue to hold the greatest amount of SNC commitments, followed by foreign bank organizations (FBOs), and other investor entities. Other investors have taken on more exposure (see exhibit 5), with the increase largely occurring in agent-identified leveraged loans.

Exhibit 5: Distribution of SNC Commitments by Lender Type

	2017 Commitments ($Billions)	2018 Commitments ($Billions)	2017 Commitments (%)	2018 Commitments (%)
U.S. Banks	$1,951.6	$1,965.3	45.3%	44.3%
FBOs	$1,457.6	$1,482.9	33.9%	33.4%
Other Investors	$894.4	$986.4	20.8%	22.2%
Total	$4,303.7	$4,434.5	100.0%	100.0%

Note: Other investors include securitization pools, hedge funds, insurance companies, and pension funds.

Other investors hold a disproportionate share of loans rated below a regulatory pass as noted in exhibit 6.

Exhibit 6: Distribution of SNC Special Mention and Classified Commitments by Lender Type

	2018 Special Mention and Classified ($Billions)	2018 Special Mention and Classified (% Share Held by Type)	2018 Special Mention and Classified (% Share of Committed)
U.S. Banks	$59.8	20.3%	3.0%
FBOs	$51.9	17.6%	3.5%
Other Investors	$183.2	62.1%	18.6%
Total	$294.9	100.0%	6.7%

Note: Other investors also owned $19.2 billion in, or 53.4 percent of all, nonaccrual loans.

Additional detail on supervisory definitions, outstanding balances, industry trends, and exposure by entity type can be found in the appendices of this document.

Appendix A: Definitions

- **Credit facilities**: Credit facilities include syndicated loans and loan commitments, letters of credit, and commercial leases, and other forms of credit. Commitment amounts include both drawn and undrawn portions of the loans or facilities. The SNC review reports only the par amounts of commitments, which may differ from the amounts at which loans are carried by investors.
- **Doubtful**: Doubtful commitments have all the weaknesses of commitments classified substandard and when the weaknesses make collection or liquidation in full, on the basis of available current information, highly questionable or improbable.
- **Loss**: Commitments classified as loss are uncollectible and of so little value that their continuance as bankable commitments is not warranted. Amounts classified as loss should be promptly charged off. This classification does not mean that there is no recovery or salvage value, but rather that it is not practical or desirable to defer writing off these commitments, even though some value may be recovered in the future.
- **Nonaccrual**: Nonaccrual loans are defined for regulatory reporting purposes as loans and lease financing receivables that are required to be reported on a nonaccrual basis because (a) they are maintained on a cash basis owing to a deterioration in the financial position of the borrower, (b) payment in full of interest or principal is not expected, or (c) principal or interest has been in default for 90 days or longer, unless the obligation is both well secured and in the process of collection.
- **Non-pass loan:** A non-pass loan is any loan that is rated special mention, substandard, doubtful or loss.
- **Pass**: A credit that is in good standing and is not criticized in any way.
- **Shared National Credit (SNC)**: A shared national credit is any loan or formal loan commitment, and any 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 to $100 million or more and is shared by three or more unaffiliated federally supervised institutions, or a portion of which is sold to two or more unaffiliated federally supervised institutions.
- **Special Mention**: Special mention commitments have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses could result in further deterioration of the repayment prospects, or in the institution's credit position in the future. Special mention commitments are not adversely rated and do not expose institutions to sufficient risk to warrant adverse rating.
- **Special Mention and Classified Commitments**: This includes all commitments rated special mention, substandard, doubtful, and loss. (Classified commitments include commitments rated substandard, doubtful, and loss.) The agencies' uniform loan classification standards and examination manuals define these risk rating classifications. Loans that are special mention and classified are considered non-pass loans.
- **Substandard**: Substandard commitments are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard commitments have well-defined weaknesses that jeopardize the liquidation of the debt and present the distinct possibility that the institution will sustain some loss if deficiencies are not corrected.

Appendix B: Committed and Outstanding Balances

(Dollars in Billions)								
Year	**Special Mention**	**Sub-Standard**	**Doubtful**	**Loss**	**Total Classified**	**Total SM + Classified**	**Total Committed**	**Total Outstanding**
1989	24.0	18.5	3.5	0.9	22.9	46.9	692	245
1990	43.1	50.8	5.8	1.8	58.4	101.5	769	321
1991	49.2	65.5	10.8	3.5	79.8	129.0	806	361
1992	50.4	56.4	12.8	3.3	72.5	122.9	798	357
1993	31.7	50.4	6.7	3.5	60.6	92.3	806	332
1994	31.4	31.1	2.7	2.3	36.1	67.5	893	298
1995	18.8	25.0	1.7	1.5	28.2	47.0	1,063	343
1996	16.8	23.1	2.6	1.4	27.1	43.9	1,200	372
1997	19.6	19.4	1.9	0.9	22.2	41.8	1,435	423
1998	22.7	17.6	3.5	0.9	22.0	44.7	1,759	562
1999	30.8	31.0	4.9	1.5	37.4	68.2	1,829	628
2000	36.0	47.9	10.7	4.7	63.3	99.3	1,951	705
2001	75.4	87.0	22.5	8.0	117.5	192.8	2,049	769
2002	79.0	112.0	26.1	19.1	157.1	236.1	1,871	692
2003	55.2	112.1	29.3	10.7	152.2	207.4	1,644	600
2004	32.8	55.1	12.5	6.4	74.0	106.8	1,545	500
2005	25.9	44.2	5.6	2.7	52.5	78.3	1,627	522
2006	33.4	58.1	2.5	1.2	61.8	95.2	1,874	626
2007	42.5	69.6	1.2	0.8	71.6	114.1	2,275	835
2008	210.4	154.9	5.5	2.6	163.1	373.4	2,789	1,208
2009	195.3	337.1	56.4	53.3	446.8	642.1	2,881	1,563
2010	142.7	256.4	32.6	15.4	304.5	447.2	2,519	1,210
2011	106.4	190.7	14.0	9.9	214.6	321.0	2,524	1,118
2012	99.3	161.7	29.5	4.6	195.8	295.1	2,792	1,243
2013	115.0	164.5	14.5	8.0	187.0	302.0	3,011	1,362
2014	149.2	171.0	11.8	7.8	191.3	340.6	3,389	1,568
2015	144.2	203.2	20.6	4.6	228.4	372.6	3,909	1,867
2016	136.4	250.7	25.7	8.6	285.1	421.4	4,102	1,986
2017	131.7	245.1	24.2	16.6	285.9	417.6	4,304	2,149
2018	112.4	173.9	5.1	3.4	182.5	294.9	4,435	2,106

Note: Figures may not add to totals due to rounding

Appendix C: Summary of SNC Industry Trends

Note: Figures may not add to totals due to rounding

(Dollars in Billions)

Industry	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Services											
Commitment	779.0	820.1	735.4	701.3	784.9	821.2	927.3	1,062.1	1,101.5	1,150.7	1,232.9
Classified	45.0	156.5	120.1	92.3	92.8	86.2	85.5	74.9	90.8	103.0	79.5
Special Mention	106.6	81.5	73.1	57.3	43.2	47.3	65.2	68.1	54.2	49.7	42.1
% Classified	5.8%	19.1%	16.3%	13.2%	11.8%	10.5%	9.2%	7.1%	8.2%	8.9%	6.4%
% Special Mention	13.7%	9.9%	9.9%	8.2%	5.5%	5.8%	7.0%	6.4%	4.9%	4.3%	3.4%
Commodities											
Commitment	578.1	658.8	592.3	593.0	665.0	709.5	788.6	904.5	937.9	937.8	907.7
Classified	12.7	77.8	57.7	42.5	34.8	39.4	43.5	72.1	114.6	111.2	50.1
Special Mention	53.6	34.9	20.4	14.0	22.4	27.7	30.0	23.1	35.7	48.2	24.8
% Classified	2.2%	11.8%	9.7%	7.2%	5.2%	5.6%	5.5%	8.0%	12.2%	11.9%	5.5%
% Special Mention	9.3%	5.3%	3.4%	2.4%	3.4%	3.9%	3.8%	2.5%	3.8%	5.1%	2.7%
Financial											
Commitment	541.0	470.9	391.3	435.4	462.6	521.9	598.3	691.7	752.0	781.7	880.5
Classified	32.5	60.4	32.6	27.6	24.7	25.3	26.7	32.2	24.7	15.4	15.3
Special Mention	13.7	28.0	17.7	9.6	9.6	12.1	19.6	20.5	18.4	9.4	14.5
% Classified	6.0%	12.8%	8.3%	6.3%	5.3%	4.8%	4.5%	4.6%	3.3%	2.0%	1.7%
% Special Mention	2.5%	5.9%	4.5%	2.2%	2.1%	2.3%	3.3%	3.0%	2.4%	1.2%	1.6%
Manufacturers											
Commitment	405.0	436.6	368.4	385.2	431.4	480.1	531.8	599.2	632.8	685.3	691.2
Classified	39.8	78.4	27.2	17.0	16.6	15.7	16.5	23.3	30.5	29.7	15.7
Special Mention	13.2	16.3	7.6	4.3	7.7	13.0	16.6	21.3	13.6	14.9	13.4
% Classified	9.8%	18.0%	7.4%	4.4%	3.9%	3.3%	3.1%	3.9%	4.8%	4.3%	2.3%
% Special Mention	3.3%	3.7%	2.1%	1.1%	1.8%	2.7%	3.1%	3.6%	2.1%	2.2%	1.9%
Real Estate											
Commitment	241.6	244.4	198.2	164.8	164.8	171.9	222.1	262.3	284.9	324.3	318.3
Classified	25.3	49.2	45.9	23.7	14.4	5.1	3.9	5.8	6.6	5.9	2.9
Special Mention	9.2	22.3	15.3	11.4	6.9	2.1	2.0	2.3	3.6	3.9	9.4
% Classified	10.5%	20.1%	23.1%	14.4%	8.8%	3.0%	1.7%	2.2%	2.3%	1.8%	0.9%
% Special Mention	3.8%	9.1%	7.7%	6.9%	4.2%	1.2%	0.9%	0.9%	1.3%	1.2%	2.9%
Distribution											
Commitment	216.0	220.5	199.0	225.9	268.7	291.3	306.5	369.8	373.4	402.9	385.2
Classified	7.7	23.2	19.6	10.0	10.7	11.8	11.0	16.7	15.0	18.0	18.4
Special Mention	13.9	12.1	8.4	9.8	8.9	12.4	15.9	8.5	11.0	5.6	8.4
% Classified	3.6%	10.5%	9.9%	4.4%	4.0%	4.1%	3.6%	4.5%	4.0%	4.5%	4.8%
% Special Mention	6.4%	5.5%	4.2%	4.4%	3.3%	4.3%	5.2%	2.3%	2.9%	1.4%	2.2%
Government											
Commitment	28.6	29.9	34.0	18.5	14.6	15.3	15.8	19.1	19.8	21.0	18.7
Classified	0.0	1.2	1.5	1.5	1.6	3.4	4.2	3.5	2.9	2.6	0.6
Special Mention	0.1	0.2	0.1	0.0	0.5	0.3	0.2	0.4	0.0	0.1	0.0
% Classified	0.0%	4.0%	4.3%	8.4%	11.0%	22.4%	26.7%	18.2%	14.6%	12.6%	3.1%
% Special Mention	0.4%	0.7%	0.4%	0.0%	3.4%	2.1%	1.4%	2.1%	0.0%	0.3%	0.0%
All Industries (Total)											
Commitment	2,789.2	2,881.2	2,518.5	2,524.2	2,792.0	3,011.1	3,390.5	3,908.8	4,102.3	4,303.7	4,434.5
Classified	163.1	446.8	304.5	214.6	195.8	187.0	191.3	228.4	285.1	285.9	182.5
Special Mention	210.4	195.3	142.7	106.4	99.3	115.0	149.4	144.2	136.4	131.7	112.4
% Classified	5.8%	15.5%	12.1%	8.5%	7.0%	6.2%	5.6%	5.8%	6.9%	6.6%	4.1%
% Special Mention	7.5%	6.8%	5.7%	4.2%	3.6%	3.8%	4.4%	3.7%	3.3%	3.1%	2.5%

Appendix D: Exposures by Entity Type

Share of Total Commitments (%)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US Banking Institutions	41.1	40.8	40.8	41.5	43.2	44.4	43.4	43.3	44.9	45.3	44.3
FBOs	39.0	38.0	37.9	38.3	36.9	35.8	34.5	33.7	33.6	33.9	33.4
Other Investors	19.9	21.2	21.3	20.2	19.8	19.7	22.1	23.0	21.6	20.8	22.2

Total Classifications ($ billion)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US Banking Institutions	47.2	134.8	81.6	49.4	35.8	29.2	25.6	40.7	63.9	66.7	35.5
FBOs	45.9	101.8	62.0	41.7	37.8	32.4	25.1	34.8	54.0	53.2	29.7
Other Investors	70.0	210.2	160.9	123.5	122.2	125.4	140.6	153.0	167.2	165.9	117.3
Totals	163.1	446.8	304.5	214.6	195.8	187.0	191.3	228.4	285.1	285.9	182.5

Classifieds as % of Commitments

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US Banking Institutions	4.1	11.5	7.9	4.7	3.0	2.2	1.7	2.4	3.5	3.4	1.8
FBOs	4.2	9.3	6.0	4.3	3.7	3.0	2.1	2.6	3.9	3.7	2.0
Other Investors	12.6	34.4	30.0	24.3	22.1	21.1	18.8	17.0	18.9	18.6	11.9
Totals	5.8	15.5	12.1	8.5	7.0	6.2	5.6	5.8	6.9	6.6	4.1

Total Nonaccrual Commitments ($ billion)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
US Banking Institutions	7.4	46.8	35.6	22.0	12.9	7.9	5.4	7.6	15.0	15.6	8.8
FBOs	5.6	35.5	28.6	18.1	15.9	11.2	6.5	7.2	15.9	12.1	7.9
Other Investors	9.3	89.8	87.0	61.0	56.9	49.7	39.2	39.7	41.8	30.3	19.1
Totals	22.3	172.1	151.2	101.1	85.6	68.8	51.1	54.5	72.6	58.0	35.8

Note: Figures may not add to totals due to rounding