Shared National Credits Program

2009 Review

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

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Executive Summary

The interagency Shared National Credit (SNC) Review for 2009 found credit quality deteriorated to record levels with respect to large loans and loan commitments held by U.S. bank organizations, foreign bank organizations (FBO), and nonbanks such as securitization pools, hedge funds, insurance companies, and pension funds. Total loss of $53 billion identified in the 2009 review exceeded the combined loss of the previous eight SNC reviews and nearly tripled the previous high in 2002. The declining credit quality is attributed to weak economic conditions affecting most industries and weak credit underwriting standards leading up to 2008.

Credit quality deteriorated across all entities, but nonbanks held 47 percent of classified assets in the SNC portfolio, despite making up only 21.2 percent of the SNC portfolio. U.S. bank organizations, which make up 40.8 percent of the SNC portfolio, held 30.2 percent of the classified assets. FBOs, which make up 38.0 percent of the SNC portfolio, held 22.8 percent of the classified assets.

Other key findings from the 2009 SNC review include:

- Criticized assets, which include SNCs rated special mention, substandard, doubtful, and loss, reached a record level of $642 billion and represented 22.3 percent of the SNC portfolio compared with 13.4 percent in 2008. Total credit commitments of nearly $2.9 trillion increased by $92 billion, or a modest 3.3 percent.
- Classified assets, which include SNCs rated substandard, doubtful, and loss, rose to $447 billion from $163 billion in 2008 and represented 15.5 percent of the SNC portfolio compared with 5.8 percent in 2008. Classified dollar volume increased 174 percent from 2008.
- Credits rated special mention declined to $195 billion from $210 billion and represented 6.8 percent of the SNC portfolio, compared with 7.5 percent in 2008. A significant number of SNCs rated special mention in 2008 migrated to classified status (substandard or worse) in 2009.
- The severity of criticism increased, with the volume of SNCs classified as doubtful and loss rising to $110 billion, up from $8 billion in 2008—a 14-fold increase. In addition, nonaccrual loans increased nearly eight times from $22 billion in 2008 to $172 billion in 2009. Nonaccrual loans included $32 billion classified loss and $56 billion classified doubtful.
- The distribution of credits across entity types—U.S. bank organizations, FBOs, and nonbanks—remained relatively unchanged. U.S. bank organizations held 40.8 percent, while FBOs and nonbanks held 38.0 percent and 21.2 percent respectively. Nonbanks continued to hold a disproportionate share of classified assets compared with their total share of the SNC portfolio. Nonbanks held 47.0 percent of classified assets and 52.0 percent of nonaccrual loans. Federal Deposit Insurance Corporation (FDIC)-insured institutions held only 24.2 percent of classified assets and 22.7 percent of nonaccrual loans.
- Criticized volume was led by the media and telecommunications industry group with $112 billion, finance and insurance with $76 billion, and real estate and construction with $72 billion. These three industry groups also represented the highest shares of criticized credits, with 17.3 percent, 11.7 percent, and 11.2 percent of criticized credits in the SNC portfolio, respectively.
- The review identified significant deterioration in credit quality of leveraged finance credits with these loans representing more than 40 percent of the dollar volume of total criticized assets. About 72 percent of the dollar volume of the 50 largest leveraged finance SNCs were criticized, which represents one-third of all criticized assets.

- Underwriting standards in 2008 improved from prior years, with examiners identifying fewer loans with structurally weak underwriting characteristics compared with 2007 and 2006 vintage credits. However, the SNC portfolio contained loans with structurally weak underwriting characteristics that were committed before mid-2007 that contributed significantly to the increase in criticized assets.

About the SNC Review

The annual SNC results are prepared and released jointly by the Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS). The 2009 SNC review included a review of $1.2 trillion in credit commitments which provided dollar coverage of 41 percent of the $2.9 trillion SNC portfolio. The 2009 SNC sample was heavily weighted toward non-investment grade and criticized credits. Results of the review are based on analyses prepared in the second quarter of 2009 using credit-related data provided by federally supervised institutions as of December 31, 2008, and March 31, 2009.

Definitions

- **Credit Facilities**—Credit facilities include syndicated loans and loan commitments, letters of credit, and commercial leases, as well as other forms of credit. Commitment amounts include both drawn and undrawn portions of the loans, or facilities. The review reports only the par amounts of commitments, which may differ from the amounts at which loans are carried by investors.

- **Criticized and Classified Assets**—Criticized assets include all assets rated special mention, substandard, doubtful, and loss. Classified assets include assets rated substandard, doubtful, and loss. The agencies' Uniform Loan Classification Standards along with the agencies' examination manuals, define these risk rating classifications.

- **Doubtful**—Doubtful assets have all the weaknesses of assets classified as substandard where the weaknesses make collection or liquidation in full, on the basis of available current information, highly questionable or improbable.

- **Loss**—Assets classified as loss are considered uncollectible and of so little value that their continuance as bankable assets 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 this asset even though some value may be recovered in the future.

- **Nonaccrua**l—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.

- **SNC**—A shared national credit is any loan and/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 $20 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. The threshold of $20 million has remained unchanged since the first report in 1977.

- **Special Mention**—Special mention assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in further deterioration of the repayment prospects or in the institutions credit position in the future. Special mention assets are not adversely classified and do not expose institutions to sufficient risk to warrant adverse classification.

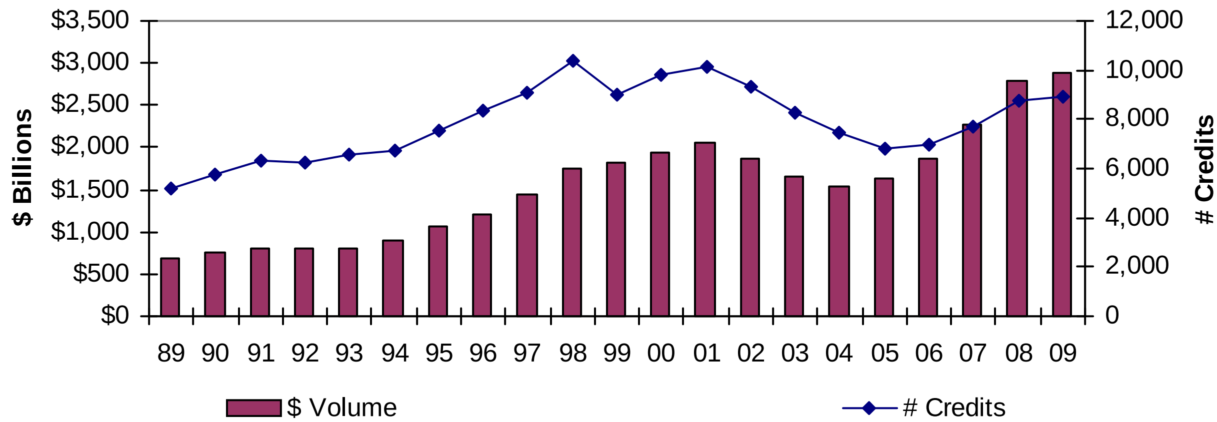
- **Substandard**—Substandard assets are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt and present the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

PART I: SNC Credit Quality

Overall SNC Portfolio

The 2009 SNC portfolio totaled $2.9 trillion, with 8,955 credit facilities to approximately 5,900 borrowers (see figure 1). The dollar volume of the SNC portfolio rose by $92 billion or 3.3 percent, while the number of credits remained nearly flat. (See appendix A for portfolio trend detail.)

Figure 1: Overall Credit Number and Commitment Trends



Four industry groups comprised 43.7 percent of the SNC portfolio. The largest groups were finance and insurance (financial sector) with $453 billion of commitments, or 15.7 percent; media and telecommunications (services sector) with $312 billion, or 10.8 percent; durables manufacturing excluding automotive (manufacturers sector) with $252 billion, or 8.8 percent; and utilities (services sector) with $241 billion, or 8.4 percent. (See appendix B for industry trend information.)

Overall SNC Credit Quality and Trends

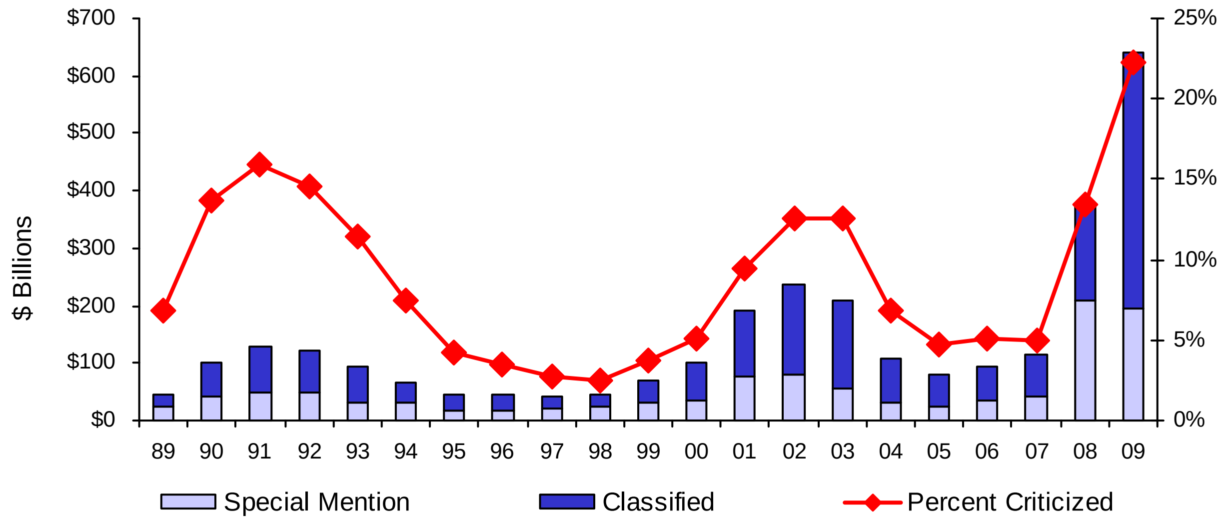
Criticized assets rose by $269 billion to $642 billion (see figure 2), a 72 percent increase, and represent 22.3 percent of the SNC portfolio compared with 13.4 percent in 2008.[1] Classified credits rose by $284 billion, a 174 percent increase, and represent 15.5 percent of the SNC portfolio compared with 5.8 percent in 2008. Credits rated special mention declined by $15 billion, or 7.1 percent, and represent 6.8 percent of the SNC portfolio compared with 7.5 percent in 2008.

In 2009, the severity of criticized assets increased significantly with a higher percentage of criticized assets falling in the substandard, doubtful, and loss categories—70 percent in 2009, compared with 44 percent in 2008. In addition, the volume of nonaccrual loans increased by nearly eight times since 2008 and totaled $172 billion, or 6.0 percent of the SNC portfolio, compared with 0.8 percent in 2008. Nonaccrual loans classified doubtful totaled $56 billion, while $32 billion was classified loss, leaving $140 billion of nonaccrual loans after charge-offs. The magnitude of total loss identified in the 2009

[1] The criticized credits and related ratios do not include the effects of hedging or other techniques that organizations often use to mitigate risk.

review of $53 billion exceeded the combined loss for the previous eight SNC reviews and nearly tripled the previous high in 2002.

Figure 2: Overall Criticized Volume and Percentage Trends



Credit Quality by Industry Sector[2]

Four industry groups accounted for 50.2 percent of total criticized assets in the SNC portfolio. The media and telecommunications industry group held the largest volume of criticized assets, with $112 billion, or 17.4 percent of total criticized assets followed by finance and insurance, with $76 billion, or 11.9 percent; real estate and construction (real estate sector), with $72 billion, or 11.2 percent; and materials and commodities excluding energy (commodities sector), with $62 billion, or 9.6 percent.

Industry groups with the highest percentage of their SNC commitments criticized were automotive-related (manufacturers sector) at 63.1 percent, commercial services (services sector) at 48.3 percent, entertainment and recreation (services sector) at 47.9 percent, and media and telecommunications at 35.8 percent. (See appendix B for trends.)

PART 2: SNC Loan Distribution

Loan Distribution by Volume

Table 1 lists the dollar volume and percentage of the SNC portfolio that were held by lender type. The percentage of SNC commitments held by U.S. banking organizations decreased slightly from 41.1 percent to 40.8 percent, while commitments held by FBOs decreased from 39.0 percent to 38.0 percent. Commitments for nonbanks rose from 19.9 percent to 21.2 percent of the portfolio. Nonbanks included

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[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 B). The seven primary sectors are further dissected into 24 industry groups constructed from 93 subgroups. The analysis in this report is prepared using the 24 industry groups.

securitization pools, hedge funds, insurance companies, and pension funds. FDIC-insured institutions' share of the SNC portfolio declined from 42.5 percent to 40.8 percent.

Table 1: Distribution of SNC Commitments by Lender Type

Lender Type	2008 Total Commitments ($ Trillion)	2009 Total Commitments ($ Trillion)	2008% Total Commitments	2009% Total Commitments
U.S. Banks	$1.1	$1.2	41.1%	40.8%
FBOs	$1.1	$1.1	39.0%	38.0%
Nonbanks	$0.6	$0.6	19.9%	21.2%
Total	$2.8	$2.9	100.0%	100.0%

Loan Distribution by Credit Quality

While nonbank entities held the smallest share of SNC commitments, they also held the largest volume and percentage of classified credits at $210 billion, or 47.0 percent of all classified credits (see appendix C). U.S. banks held $135 billion of classified credits, or 30.2 percent, and FBOs held $102 billion, or 22.8 percent. In addition, 34.4 percent of nonbank credits were classified compared with only 11.5 percent of the U.S. bank portfolio and 9.3 percent of the FBO portfolio. Of nonaccrual loans, nonbank institutions held 52.2 percent, with only $39 billion, or 22.7 percent held by FDIC-insured institutions.

Each lender type experienced significant growth in classified credits over the past year. Classified credits held by nonbanks increased $140 billion to $210 billion, or 200 percent; U.S. bank classified credits increased $88 billion to $135 billion, or 186 percent; and FBO classified credits increased $56 billion to $102 billion, or 122 percent. (See appendix C.)

PART 3: Leveraged Finance Trends

The agencies estimated that leveraged finance SNCs made up approximately $500 billion, or 17 percent of the SNC portfolio. This determination was based on observed loan characteristics (e.g., origination date, loan pricing, loan purpose, and loan structure) of loans sampled for review.

The review identified significant deterioration in credit quality of leveraged finance credits with these loans representing more than 40 percent of the dollar volume of total criticized assets. About 72 percent of the dollar volume of the 50 largest leveraged finance SNCs were criticized, which represents one-third of all criticized assets.

Borrowers with highly leveraged balance sheets are very sensitive to credit quality deterioration during economic downturns. Syndicated loans that were poorly structured, underwritten with overly optimistic projections, and/or lacked capability for sufficient cash flow to deleverage and repay senior debt were subject to regulatory criticism. Actual or expected operating performance of leveraged borrowers relative to underwriting projections was most disparate in the following sectors: entertainment and recreation, media and telecommunications, real estate and construction, durables and manufacturing, material and commodities, transportation, and retail stores. As expected, the decline in leveraged borrower performance correlated to the increase in criticized loans cited during the SNC review.

PART 4: Syndicated Loan Underwriting Trends

This is the third consecutive SNC review in which examiners conducted a review of syndicated loan underwriting standards. The SNC review included an evaluation of underwriting standards on approximately 260 credits booked, or funded, in 2008. Areas evaluated included structure, repayment terms, pricing, collateral, loan agreements, and financial analysis and monitoring techniques.

As expected, underwriting standards tightened in 2008. Examiners noted a reduction in new loans with structurally weak underwriting characteristics[3] compared with 2007. However, consistent with 2007, liberal repayment and repayment dependent on refinancing remained the two most common underwriting weaknesses. Despite a return to more reasonable underwriting standards, the SNC portfolio contained a significant volume of loans with structurally weak underwriting characteristics that were committed before mid-2007. These "legacy" loans continued to adversely affect credit quality of the SNC portfolio by migrating to criticized status.

Bank management should ensure underwriting practices include a comprehensive and realistic assessment of a borrower's capacity to repay or deleverage over a reasonable period of time. SNCs with structurally weak underwriting characteristics and borrower financial performance and projections that do not support the prospects of reasonable repayment will be subject to regulatory criticism by the agencies.

[3]Structurally weak underwriting characteristics include liberal repayment terms, repayment dependent on refinancing, nonexistent or weak loan covenants, inadequate collateral or collateral valuations, repayment dependent on inadequately supported cash flows, inadequate financial analysis, and speculative or unclear loan purpose.

Appendix A: Committed and Outstanding Balances

(In Billions of Dollars)

Year	Special Mention	Sub-Standard	Doubtful	Loss	Total Classified	Total Criticized	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

Note: Figures may not add to totals due to rounding.

Appendix C: Exposure by Entity Type

Share of Total Commitments (%)

	2002	2003	2004	2005	2006	2007	2008	2009
US Banking Institutions	**45.3**	**45.4**	**46.5**	**44.8**	**44.3**	**42.7**	**41.1**	**40.8**
Insured	42.8	42.5	43.4	41.5	40.8	38.9	37.4	35.0
Uninsured(*)	2.5	2.9	3.1	3.3	3.5	3.8	3.7	5.8
FBOs	**44.8**	**43.8**	**41.6**	**42.1**	**41.5**	**41.4**	**39.0**	**38.0**
Insured	5.1	5.4	5.5	6.0	6.2	6.4	5.1	5.8
Uninsured	39.7	38.4	36.1	36.1	35.3	35.0	33.9	32.2
Nonbanks	**9.9**	**10.8**	**12.0**	**13.1**	**14.3**	**15.9**	**19.9**	**21.2**

Total Classifications ($ billion)

	2002	2003	2004	2005	2006	2007	2008	2009
US Banking Institutions	**53.7**	**43.6**	**18.8**	**11.9**	**13.1**	**19.2**	**47.2**	**134.8**
Insured	47.6	37.8	16.0	8.6	9.0	13.2	38.3	96.3
Uninsured(*)	6.0	5.8	2.8	3.2	4.1	6.0	9.0	38.6
FBOs	**60.0**	**65.0**	**31.3**	**15.5**	**17.3**	**17.6**	**45.9**	**101.8**
Insured	8.4	6.8	2.8	1.5	1.6	2.3	5.1	11.7
Uninsured	51.6	58.3	28.5	14.0	15.7	15.4	40.8	90.1
Nonbanks	**42.1**	**43.6**	**24.0**	**25.0**	**31.5**	**34.8**	**70.0**	**210.2**
Totals	**155.8**	**152.2**	**74.2**	**52.5**	**61.8**	**71.6**	**163.1**	**446.8**

Classifieds as % of Commitments

	2002	2003	2004	2005	2006	2007	2008	2009
US Banking Institutions	**6.4**	**5.8**	**2.6**	**1.6**	**1.6**	**2.0**	**4.1**	**11.5**
Insured	5.7	5.1	2.2	1.2	1.1	1.4	3.3	8.2
Uninsured(*)	0.7	0.8	0.4	0.4	0.5	0.6	0.8	3.3
FBOs	**7.2**	**9.0**	**4.9**	**2.3**	**2.2**	**1.9**	**4.2**	**9.3**
Insured	1.0	0.9	0.4	0.2	0.2	0.2	0.5	1.1
Uninsured	6.2	8.1	4.4	2.0	2.0	1.6	3.7	8.2
Nonbanks	**22.9**	**24.5**	**13.0**	**11.7**	**11.8**	**9.6**	**12.6**	**34.4**
Totals	**8.4**	**9.3**	**4.8**	**3.2**	**3.3**	**3.1**	**5.8**	**15.5**

Total Nonaccrual Commitments ($ billion)

	2002	2003	2004	2005	2006	2007	2008	2009
US Banking Institutions	**22.5**	**18.4**	**7.7**	**3.9**	**2.8**	**0.8**	**7.4**	**46.8**
Insured	19.4	16.5	0.1	3.1	1.8	0.5	**6.3**	**35.5**
Uninsured(*)	3.1	1.9	7.6	0.8	1.0	0.3	**1.1**	**11.3**
FBOs	**30.5**	**29.5**	**17.6**	**9.0**	**4.7**	**0.9**	**5.6**	**35.5**
Insured	3.9	3.2	-	0.4	0.4	0.2	**1.0**	**3.6**
Uninsured	26.6	26.3	17.6	8.6	4.3	0.7	**4.6**	**31.9**
Nonbanks	**21.1**	**20.5**	**12.3**	**11.9**	**10.2**	**2.2**	**9.3**	**89.8**
Totals	**74.1**	**68.4**	**37.6**	**24.8**	**17.7**	**3.9**	**22.3**	**172.1**

(*)Uninsured refers to organizations that do not take consumer deposits such as holding companies, brokerage firms, finance companies, etc.

Note: Figures may not add to totals due to rounding