

Corporate & Financial Weekly Digest

August 26, 2011 by [Jeffrey M. Werthan](#)

Federal Reserve, OCC, and FDIC Announce Results of Shared National Credit Review

On August 25, the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (the agencies) announced the results of the shared national credit (SNC) annual review. A SNC 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 \$20 million or more and is shared by three or more unaffiliated supervised institutions. Many of these loan commitments are also shared with foreign banking organizations (FBOs) and nonbanks, including securitization pools, hedge funds, insurance companies, and pension funds.

The agencies stated that the credit quality of large loan commitments owned by U.S. banking organizations, FBOs, and nonbanks improved in 2011 for the second consecutive year, according to the 2011 SNC Review. A loan commitment is the obligation of a lender to make loans or issue letters of credit pursuant to a formal loan agreement.

Total criticized loans declined more than 28 percent to \$321 billion in 2011, although the percentage of criticized assets remained high compared to pre-financial crisis levels. A criticized loan is rated special mention, substandard, doubtful, or loss. Loans rated as doubtful or loss (the two weakest categories) fell 50 percent to \$24 billion in 2011.

Reasons for improvement in credit quality included better operating performance among borrowers, debt restructurings, bankruptcy resolutions, and ongoing access to bond and equity markets. Industries that led the improvement in credit quality were real estate and construction, media and telecommunications, and finance and insurance.

Despite this progress, poorly underwritten loans originated in 2006 and 2007 continued to adversely affect the SNC portfolio. Approximately 60 percent of criticized assets originated in these years. Refinancing risk remained elevated as nearly \$2 trillion, or 78 percent of the SNC portfolio, matures by the end of 2014. Of this maturing amount, \$204 billion was criticized. It is noteworthy that although nonbank entities, such as securitization pools, hedge funds, insurance companies, and pension funds, owned the smallest share of loan commitments, they owned the largest share (58 percent) of classified credits (rated substandard, doubtful, or loss).

In other highlights of the review:

- Total SNC commitments increased less than 1 percent from the 2010 review. Total SNC loans outstanding fell \$93 billion to \$1.1 trillion, a decline of 8 percent.

- Criticized assets represented 13 percent of the SNC portfolio, compared with 18 percent in 2010.
- Classified assets declined 30 percent to \$215 billion in 2011 and represented 9 percent of the portfolio, compared with 12 percent in 2010.
- Credits rated special mention, which exhibited potential weakness and could result in further deterioration if uncorrected, declined 25 percent to \$106 billion in 2011 and represented 4 percent of the portfolio, compared with 6 percent in 2010.
- Nonaccruals declined to \$101 billion from \$151 billion. Adjusted for losses, nonaccrual loans declined to \$92 billion from \$137 billion, a 33 percent reduction.
- The distribution of credits across entities (U.S. banking organizations, FBOs, and nonbanks) remained relatively unchanged. U.S. banking organizations owned 42 percent of total SNC loan commitments, FBOs owned 38 percent, and nonbanks owned 20 percent. The share owned by nonbanks declined for the first time since 2001. Nonbanks continued to own a larger share of classified (58 percent) and nonaccrual (60 percent) assets compared with their total share of the SNC portfolio. Institutions insured by the Federal Deposit Insurance Corporation owned only 17 percent of classified assets and 15 percent of nonaccrual loans.
- The media and telecommunications industry group led other industry groups in criticized volume with \$70 billion. Finance and insurance followed with \$37 billion, then real estate and construction with \$35 billion. Although these groups had the largest dollar volume of criticized loans, the three groups with the highest percentage of criticized loans were entertainment and recreation, media and telecommunications, and commercial services.
- The 2011 review indicated that the number of credits originated in 2010 rose dramatically compared to 2009 and 2008. Although the overall quality of underwriting in 2010 was significantly better than in 2007, some easing of standards was noted compared to the relatively tighter standards in 2009 and the latter half of 2008.

In conducting the 2011 SNC Review, the agencies reviewed \$910 billion of the \$2.5 trillion credit commitments in the portfolio. The sample was weighted toward non-investment grade and criticized credits. The results of the review are based on analyses prepared in the second quarter of 2011 using credit-related data provided by federally supervised institutions as of December 31, 2010, and March 31, 2011.

To view the results of the shared national credit annual review, click [here](#).

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