December 2002

Monetary*Trends*

THE FEDERAL RESERVE BANK of ST. LOUIS

Exposure of U.S. Banks to Problem Syndicated Loans

The three federal bank supervisory agencies—the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation—have conducted joint reviews of shared national credits (SNCs) annually since 1977. These SNCs (commonly called "syndicated loans") are currently defined as loans or loan commitments of at least $20 million that are shared by three or more financial institutions. The reviews conducted during May and June 2002 covered $1.9 trillion of loan commitments to 5,542 borrowers.[1] Of these loan commitments, outstanding loans were $692 billion, which is about 69 percent of the commercial and industrial loans of all commercial banks (including foreign related institutions).

When examiners rate these credits, they look for any weaknesses. If they identify well-defined weaknesses, examiners rate the credits as "substandard," "doubtful," or "loss." The sum of the credits in these three categories is called total classified credits. The credits that examiners rate as doubtful have more serious problems than the credits they rate as substandard. Credits rated as loss are considered uncollectable. In addition to classified credits, examiners rate some credits as "special mention" because of potential weaknesses that, if left uncorrected, could lead to further deterioration.

The 2002 report on SNCs includes some innovations. The criterion for identifying U.S. banks and foreign banking organizations was changed in 2002. Credits of the U.S. chartered subsidiaries of foreign banking organizations are now reported as credits of foreign banking organizations, whereas in prior SNCs reports these credits were reported as credits of U.S. banks. The 2002 report incorporates this new criterion retroactively for data on the credits of domestic and foreign banking organizations back to 2000. In addition, the 2002 report presents the specific allocations of classified and special mention credits among U.S. banks, foreign owned banking organizations, and nonbank lenders to firms in the industry category that had the greatest deterioration in loan quality in the current year: telecommunications and cable.

The figure indicates that the share of adversely rated SNCs has increased since 1998 to a level in 2002 that is comparable to that in the early 1990s. The table, however, presents a more sanguine view of credit quality at U.S. banks. Classified SNCs tend to be concentrated among the credits of nonbank lenders. In addition, the percentages of credits in the telecommunications and cable industry that are classified or subject to special mention were higher for nonbank lenders than for U.S. or foreign banks.

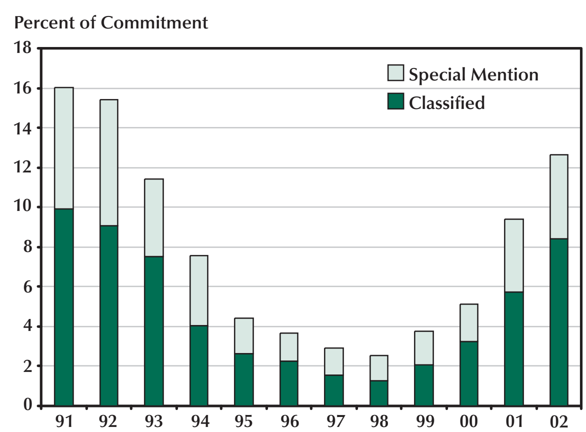
The difference in classification rates for banks and those for nonbank lenders appears to reflect the distinct choices that these two types of institutions make regarding the risk characteristics of the credits they wish to hold in their portfolios. The 2002 report on SNCs describes this market segmentation as follows:

> "The significantly higher classification rate for nonbanks is consistent with market observations that nonbanks have largely focused on subinvestment grade investments and have been purchasers of distressed loans in the secondary market at discounts to par."

—R. Alton Gilbert

[1] The SNCs reports are available on the Internet at <www.federalreserve.gov/releases/snc/default.htm>.

Adversely Related Credits



Credits Classified as Substandard, Doubtful, or Loss

Type of lender	2002	2001	2000
U.S. Bank	6.5%	5.2%	2.8%
Foreign banking organization	7.3	4.7	2.6
Nonbank lender	22.6	14.5	10.2

Views expressed do not necessarily reflect official positions of the Federal Reserve System.