



FEDERAL RESERVE BANK
OF DALLAS

DALLAS, TEXAS
75265-5906

October 16, 2002

Notice 02-55

TO: The Chief Executive Officer of each
financial institution and others concerned
in the Eleventh Federal Reserve District

SUBJECT

**Bank Regulators' Data Show Continued Increase in
Adversely Classified Syndicated Bank Loans**

DETAILS

According to a joint agency press release, the quality of large syndicated bank loans continued to deteriorate during 2002, but at a slower rate than was evident in 2001. The deterioration was consistent with general economic, sectorial, and credit market trends. The results—reported by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation—are based on analyses prepared in the second quarter and reflect business and economic conditions that prevailed at that time.

ATTACHMENT

A copy of the joint press release dated October 8, 2002, is attached.

MORE INFORMATION

For more information, please contact Bobby Coberly, Banking Supervision Department, (214) 922-6209. Paper copies of this notice or previous Federal Reserve Bank notices can be printed from our web site at <http://www.dallasfed.org/banking/notices/index.html>.

Joint Release

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

For Immediate Release

October 8, 2002

**Bank Regulatory Agencies Find Adversely Rated Syndicated Loans
Continue to Increase in 2002, but at Slower Rate than Previous Year**

WASHINGTON -- The quality of large syndicated bank loans continued to deteriorate this year, but at a slower rate than was evident in 2001, according to the 2002 Shared National Credit (SNC)¹ review, which federal bank regulators released today. The deterioration was consistent with general economic, sectorial, and credit market trends.

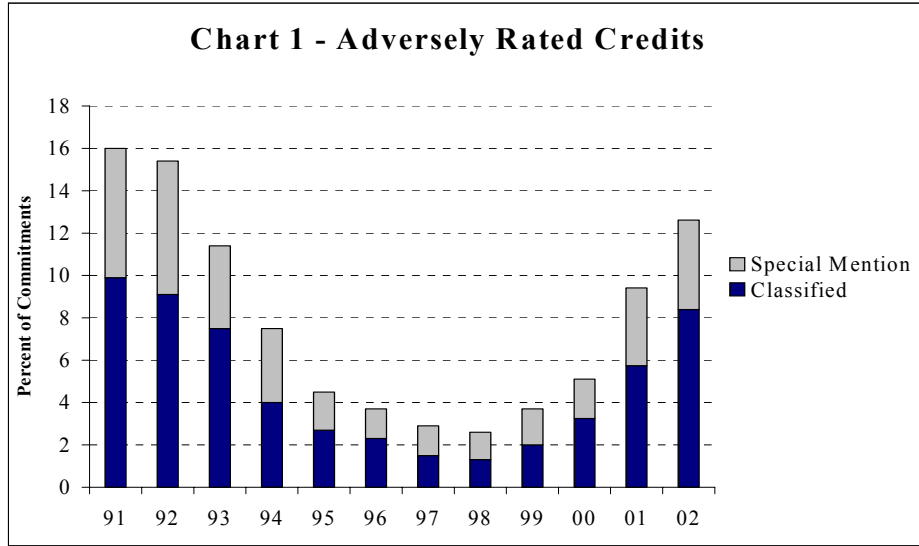
The results -- reported by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation -- are based on analyses that were prepared during the second quarter and reflect business and economic conditions that prevailed at that time.

For the 2002 review, total loan commitments classified as either substandard, doubtful or loss rose by \$39.4 billion or 34 percent over the previous year, compared to a net increase of \$54.3 billion or 86 percent the year before. At the same time, commitments rated special mention rose \$3.6 billion or 5 percent compared to \$39.1 billion or 108 percent the year before.

Adversely rated credits are the total of loans classified substandard, doubtful, and loss and loans rated special mention. Under the agencies' Uniform Loan Classification Standards, classified loans have well defined weaknesses, including default in some cases, while special mention loans exhibit potential weaknesses, which may result in further deterioration if left uncorrected.

Deterioration since the middle of last year was largely driven by the pronounced problems in the telecommunication sector, alleged corporate fraud, weakness from the recent recession, and the after-effects of September 11th. Similar to last year, deterioration has been particularly evident for credits to leveraged and speculative-grade borrowers that are facing difficulty generating sufficient cash flow to service their debts because of over capacity, weaker pricing or slower than anticipated growth. At the same time, certain market segments have shown moderate improvement, with the professional, scientific, financial, insurance and other service sectors showing lower classification levels relative to 2001.

In 2002, the SNC Program covered 9,328 credits totaling \$1.9 trillion in loan commitments to 5,542 borrowers. Of the total commitments, \$692 billion was advanced and outstanding. Classified credits totaled \$157.1 billion, or 8.4 percent of total commitments, up from \$117.6 billion or 5.7 percent in 2001. At the same time, loans listed for special mention rose to 4.2 percent of total commitments, from 3.7 percent in 2001. On a combined basis, special mention and classified loans represent 12.6 percent of total commitments, up from 9.4 percent a year ago but still below the peak of 16 percent in 1991 (see Chart 1 and Appendix A). None of these figures include the effects of hedging or other techniques that individual organizations might have employed to mitigate risk.



Of particular note for 2002 was a record \$19.6 billion in commitments characterized as loss, up \$11.6 billion from the year before. Of that total, \$7.6 billion or 39 percent was attributable to the telecommunication and cable industries.

Of the \$1.9 trillion in total SNC commitments, U.S. banking organizations² and foreign banking organizations (FBO) each held 45 percent of the exposures, and nonbank firms held the remaining 10 percent (see top panel of Table 1). Since 2000, the share of commitments held by U.S. banks has fallen somewhat, while the nonbank share has grown. For 2002, the rate of deterioration for credits held by these groups has differed markedly, with U.S. banking organizations experiencing an 11 percent increase in classifieds, compared to 39 percent for FBOs and 68 percent for nonbanks. Classifications as a percent of commitments also showed a wide range with U.S. banks exhibiting lower overall problems relative to FBOs or nonbanks (see bottom panel).

Table 1 - Exposures by Entity Type

	2002	2001	2000
Share of Total Commitments (%)			
U.S. Bank	45%	46%	48%
FBO	45%	46%	45%
Nonbank	10%	8%	7%
Total Classifications (\$ billions)			
U.S. Bank	54.4	48.8	26.6
FBO	61.8	44.4	22.8
Nonbank	41.0	24.4	13.9
Total	157.1	117.6	63.4
Total Classifications (% Increase)			
U.S. Bank	11%	83%	72%
FBO	39%	95%	69%
Nonbank	68%	75%	65%
Total	34%	86%	69%
Classified as % of Commitments			
U.S. Bank	6.5%	5.2%	2.8%
FBO	7.3%	4.7%	2.6%
Nonbank	22.6%	14.5%	10.2%
Total	8.4%	5.7%	3.2%

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 value; all dollar amounts in this release are par amounts. In addition, nonbanks and U.S. banks each held 27 percent of the loss classification, while FBOs held the remaining 46 percent.

Over the past year, the telecommunication and cable industries experienced the steepest decline in quality, with three-quarters of the \$40 billion increase in SNC classifieds attributable to this segment. For 2002, total classifications for the sector soared to 27.0 percent of total commitments, compared to 3.9 percent the year before (see bottom panel of Table 2).

Table 2 - Telecom & Cable Classifications (2002)

Committed Amounts (\$Bill)	Total Telecom	Telecom-Related Held By:		
		U.S. Banks	FBOs	Nonbanks
Substandard	23.6	7.8	8.9	6.9
Doubtful	5.0	1.2	2.8	1.0
Loss	7.6	1.8	3.2	2.6
Total Classified	36.3	10.8	15.0	10.5
Special Mention	7.9	2.3	3.1	2.4
Total Criticized	44.2	13.1	18.1	12.9
% share	100%	30%	41%	29%

Classified as % of Commitment				
2002	27.0%	24.0%	25.0%	35.8%
2001	3.9%	3.3%	3.3%	10.0%
SNC Commitments Held (\$Bill)				
2002	134.4	45.0	60.0	29.4
2001	162.2	59.2	74.1	28.9
Share of Telecom Held (%)				
2002	100%	34%	45%	22%
2001	100%	36%	46%	18%

The second largest increase in classifications was attributable to the oil, gas, pipelines and utilities industries, with a \$12.7 billion increase and a classification rate of 7.5 percent, compared to 1.9 percent the year before (see Appendix B). Special mention credits for this segment more than doubled and amounted to 6.9 percent of commitments. Although the manufacturing industry exhibits the largest dollar volume of classified and criticized assets within the SNC portfolio, the rate of deterioration has diminished markedly from the prior year, with classifieds growing just 5 percent. The 1.5 percentage point rise in the manufacturing classification rate to 12.1 percent is largely a function of an 8 percent decline in outstanding commitments, rather than a marked growth in problem credits. On the positive side, classifications in the professional, scientific and other services industry fell by \$3.9 billion, and classifieds for financial services and insurance industries declined by \$3.0 billion.

For the most part, banking organizations have been vigilant in identifying problem credits and reflecting deterioration in the quality of syndicated loans in their internal credit ratings. A combination of factors, including strong earnings and capital bases, coupled with diverse revenue sources and balance sheets have allowed U.S. banking organizations to absorb deteriorating credit conditions over the past three years without the disruption experienced a decade ago. Nevertheless, banking organizations must continue to be vigilant in the current environment to ensure that they promptly identify and address any continuation in credit quality deterioration and adjust loans loss allowance levels appropriately³.

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Appendix A

Summary of Shared National Credit Trends

Committed Balances								
(Dollars in Billions)								
Year	Special Mention	Sub- standard	Doubtful	Loss	Total Classified	Total Adversely Rated	Total Committed	Total Outstanding
1991	49.2	65.5	10.8	3.5	79.8	129.0	806	#
1992	50.4	56.4	12.8	3.3	72.5	122.9	798	#
1993	31.4	50.4	6.7	3.5	60.6	92.0	806	331
1994	31.5	31.1	2.7	2.3	36.1	67.6	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	22.8	17.6	3.5	0.9	22.0	44.8	1,759	561
1999	31.3	31.0	4.9	1.5	37.4	68.7	1,829	629
2000	36.3	47.9	10.8	4.7	63.4	99.7	1,951	705
2001	75.4	87.0	22.6	8.0	117.6	192.8	2,050	769
2002	79.0	112.0	25.5	19.6	157.1	236.1	1,871	692

- Data are not available.

Appendix B**Summary of SNC Industry Trends⁴ 2000-2002 (\$Billions)**

Industry	2002	2001	2000
Telecommunication & Cable			
Commitment	134.4	162.2	139.7
Classified	36.3	6.5	2.1
Special Mention	7.9	11.8	3.4
% Classified	27.0%	4.0%	1.5%
% Special Mention	5.9%	7.3%	2.4%
Manufacturing			
Commitment	499.0	543.7	574.7
Classified	60.2	57.4	19.6
Special Mention	24.7	25.9	18.3
% Classified	12.1%	10.6%	3.4%
% Special Mention	4.9%	4.8%	3.2%
Professional, Scientific, & Other Services			
Commitment	98.5	123.4	180.2
Classified	7.8	11.7	13.2
Special Mention	1.6	2.4	4.0
% Classified	7.8%	9.5%	7.3%
% Special Mention	1.6%	1.9%	2.2%
Oil, Gas, Pipelines & Utilities			
Commitment	226.1	224.5	174.5
Classified	17.0	4.3	4.0
Special Mention	15.5	7.0	1.0
% Classified	7.5%	1.9%	2.3%
% Special Mention	6.9%	3.1%	0.6%
Construction, Real Estate, Lodging & Transportation			
Commitment	182.9	199.0	106.4
Classified	9.3	7.8	1.4
Special Mention	10.3	5.3	1.0
% Classified	5.1%	3.9%	1.3%
% Special Mention	5.6%	2.7%	0.9%
Financial Services & Insurance			
Commitment	410.0	460.1	504.0
Classified	9.0	12.0	14.3
Special Mention	3.7	4.3	2.4
% Classified	2.2%	2.6%	2.8%
% Special Mention	0.9%	0.9%	0.5%
All Other			
Commitment	320.3	337.5	271.5
Classified	17.5	18.0	8.7
Special Mention	15.2	18.7	6.1
% Classified	5.5%	5.3%	3.3%
% Special Mention	4.8%	5.5%	2.3%
All Industries (Total)			
Commitment	1,871.2	2,050.4	1,951.0
Classified	157.1	117.6	63.4
Special Mention	79.0	75.4	36.3
% Classified	8.4%	5.7%	3.2%
% Special Mention	4.2%	3.7%	1.9%

Endnotes

¹ The Shared National Credit (SNC) Program was established in 1977 by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to provide an efficient and consistent review and classification of large syndicated loans. The annual program covers loans or loan commitments of at least \$20 million that are shared by three or more financial institutions.

² To better reflect ultimate ownership, in this year's press release U.S. banks are defined to exclude U.S. chartered subsidiaries of foreign banking organizations for the years 2000 through 2002. Last year's press release data included those subsidiaries under U.S. banks, even if they were consolidated under the FBO's worldwide banking organization.

³ For further guidance, institutions should refer to the July 12, 1999 Joint Interagency Letter to Financial Institutions on the allowance for loan losses, as well as the December 1993 Interagency Policy Statement on the Allowance for Loan and Lease Losses.

⁴ Due to the recent conversion of industry classification codes (from SIC to NAICS), the specificity of 2002 and 2001 data exceeds that available for 2000. Accordingly, consistent year-to-year comparisons of industry sector information are not always possible. NAICS groupings of industries identified in Appendix B for 2002 and 2001 are as follows: Telecommunication & Cable (5132 through 51339); Manufacturing – 31 to 33; Professional, Scientific, and Other Services – 54, 55, 56, 61, 62; Oil, Gas, Pipelines, and Utilities – 21 (oil- & gas-related only), 22, 486; Construction, Real Estate, Lodging and Transportation – 23, 48 (excluding 486), 49, 53, 72; Finance and Insurance – 52; All Other – Remaining NAICS codes.