

**Survey of
Credit Underwriting
Practices
2005**

**Office of the Comptroller of the Currency
National Credit Committee**

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Introduction

The Office of the Comptroller of the Currency (OCC) conducted its eleventh annual survey of credit underwriting practices during the first quarter of 2005. The survey identified trends in lending standards and credit risk for the most common types of commercial and retail credit offered by national banks.

The 2005 survey included the 71 largest national banks and covered the 12-month period ending March 31, 2005. Although mergers and acquisitions have altered the survey population, the surveys covered substantially the same group of banks for the last 10 years. All companies in the 2005 survey have assets of \$2 billion or greater. The aggregate loan portfolio of banks included in the 2005 survey was approximately \$2.9 trillion as of December 31, 2004. This represents over 90 percent of all outstanding loans in national banks.

The OCC examiners-in-charge of the surveyed banks were asked a series of questions concerning overall credit trends for 18 types of commercial and retail credit. Commercial credit for purposes of this survey included 10 categories of loans: syndicated/national loans, structured finance (leveraged finance), asset-based loans, middle market loans, small business loans, international credits, agricultural loans, residential construction, commercial construction, and other commercial real estate. Retail credit consisted of eight categories of loans: residential real estate mortgages, affordable housing, credit cards, other direct consumer loans, indirect consumer paper (loans originated by others, such as car dealers), consumer leasing, conventional home equity, and high loan-to-value (HLTV) home equity loans.

The term “underwriting standards,” as used in this report, refers to requirements, such as ones related to collateral, loan maturities, pricing, and covenants, that banks establish when originating and structuring loans. Conclusions about “easing” or “tightening” of underwriting standards are drawn from OCC examiners’ observations since the 2004 survey. A conclusion that the underwriting standards for a particular loan category have eased or tightened does not indicate that all the standards for that particular category have been adjusted. It indicates that the adjustments that did occur had the net effect of easing or tightening such underwriting criteria.

Part I of this report discusses the overall results of the survey. Part II depicts the survey results in graphs and tables.

Part I: Overall Results

Primary Findings

- *The 2005 survey results indicate increased easing of commercial credit underwriting standards. Over one-third of the banks eased standards and easing was reported for most commercial products.*
- *Underwriting standards for retail credit products also reflects increased easing with easing centered in real estate secured products.*
- *Examiners reported that credit risk has increased during the past year, with further increase in credit risk expected during the next 12 months.*

Commercial Underwriting Standards

In 2005, there is a pronounced trend toward easing commercial credit standards, with significantly more banks easing underwriting standards than tightening standards. Examiners reported that 34 percent of banks eased, 12 percent tightened, and 54 percent made no change to commercial underwriting standards. The easing trend began modestly in 2004 when examiners reported that 13 percent of banks eased, 12 percent tightened, and 75 percent did not change their commercial underwriting standards. From 1999 until 2004, more banks tightened than eased credit standards. The last time examiners reported more banks easing credit standards than tightening standards was in 1998, when 44 percent of the banks eased commercial standards.

Commercial underwriting trends at the product level confirm the shift toward easing. Examiners noted eased standards for all of the commercial products except agriculture loans. Easing is most prevalent in syndicated/national, structured finance, asset-based, and international loans. However, fewer banks are involved in these lending activities. Significant easing also was reported for commercial real estate and middle market loans, products which most banks offer and, therefore, have a potentially greater impact on credit quality. Examiners noted that this is the second year of net easing for structured finance, asset-based lending, and middle market products.

Once again, examiners cited competition as the primary reason for easing commercial credit standards, followed by risk appetite and market strategy. As in prior years, the most common method of easing standards is pricing. Banks also continue to ease standards by adjusting covenants, increasing the amount of the credit line, lengthening maturity, and changing collateral requirements. For those banks that tightened standards, the primary reasons were a change in risk appetite and product performance. When tightening standards, banks commonly relied on adjustments to collateral requirements.

Examiners reported that credit risk trends in commercial portfolios have increased slightly and are expected to continue to increase during the next 12 months. The percentage of banks with increased commercial credit risk slightly exceeds those banks with decreased risk. The shift in

risk is attributed to increased competition and the change in banks' risk appetite. Examiners reported the greatest increase in risk is centered in commercial real estate products—including residential construction lending—frequently citing the high growth rates of these products as well as easing standards.

Retail Underwriting Standards

While underwriting standards for retail credit traditionally have been more stable, examiners noted easing of retail underwriting standards in over one-quarter of the banks surveyed. Specifically, 28 percent of the banks eased standards, 10 percent tightened, and 62 percent made no change. This is up considerably from 2004 when the number of banks easing retail credit standards (13 percent) equaled the number of banks tightening (13 percent). Notably, this is the first time in the survey's 11-year history that examiners reported net easing of retail underwriting standards.

The easing of retail credit standards is primarily concentrated in home equity products and residential real estate lending. Indirect consumer loans and affordable housing loans also experienced some easing. Among the retail products, only credit cards and other direct consumer loans (e.g., auto loans or personal loans) exhibited net tightening.

According to examiners, banks continue to ease retail standards primarily because of increased competition, while tightening results primarily from a decreased risk appetite. Regulatory expectations also played a role in the tightening of credit card standards. Banks reduced debt service requirements, extended amortization schedules and lowered collateral requirements when easing credit standards. To tighten underwriting standards, examiners reported banks primarily adjusted scorecard cutoffs and pricing.

Examiners reported that nearly 75 percent of the banks surveyed had no change in the overall level of retail credit risk during the past 12 months. However, examiners expect retail credit risk to increase in 28 percent of banks and decrease in only 6 percent of the banks over the next 12 months. Examiners reported that credit risk increased in most products in the past 12 months, but this was particularly evident in home equity and residential real estate products. Examiners cited the high growth rates coupled with the potential for higher interest rates and continued competition as the primary factors contributing to the increased risk in these products.

Commentary

With our eleventh annual survey of credit underwriting practices, we see a clear trend toward easing of underwriting standards as banks stretch for volume and yield. While the performance of commercial and retail portfolios remains satisfactory, credit risk is increasing and expected to continue to increase over the next twelve months.

Ambitious growth goals in a highly competitive market can create an environment that fosters imprudent credit decisions. As the adage goes, “the worst of loans are made in the best of times.” Banks should be diligent to ensure risk management practices keep pace with new products, changing risk selection practices and underwriting standards, and emerging concentrations. Exceptions to underwriting standards need to be carefully controlled and monitored, and relationship and line of business managers must be held accountable for loan quality as well as loan volume.

Commercial and residential real estate secured loans have experienced high growth rates resulting in growing concentration levels. For all residential portfolios, rapid appreciation of housing values has raised concerns about price volatility and over-valued markets, while for commercial portfolios, certain property types and markets continue to exhibit weaknesses. These portfolios are particularly vulnerable to interest rate increases. Banks should ensure these portfolios receive appropriate oversight.

Easing of commercial credit standards is not unusual after five years of tightening, improved credit quality, and several quarters of healthy corporate profits. Nonetheless, given the competitive environment and liquid market conditions, banks should approach further easing with caution.

Retail lending has undergone a dramatic transformation in recent years as banks have aggressively moved into the retail arena to solidify market positions and gain market share. Higher credit limits and loan-to-value ratios, lower credit scores, lower minimum payments, more revolving debt, less documentation and verification, and lengthening amortizations — have introduced more risk to retail portfolios. While performance remains sound, banks should be wary of the unseasoned nature of many of these portfolios and approach further easing with caution.

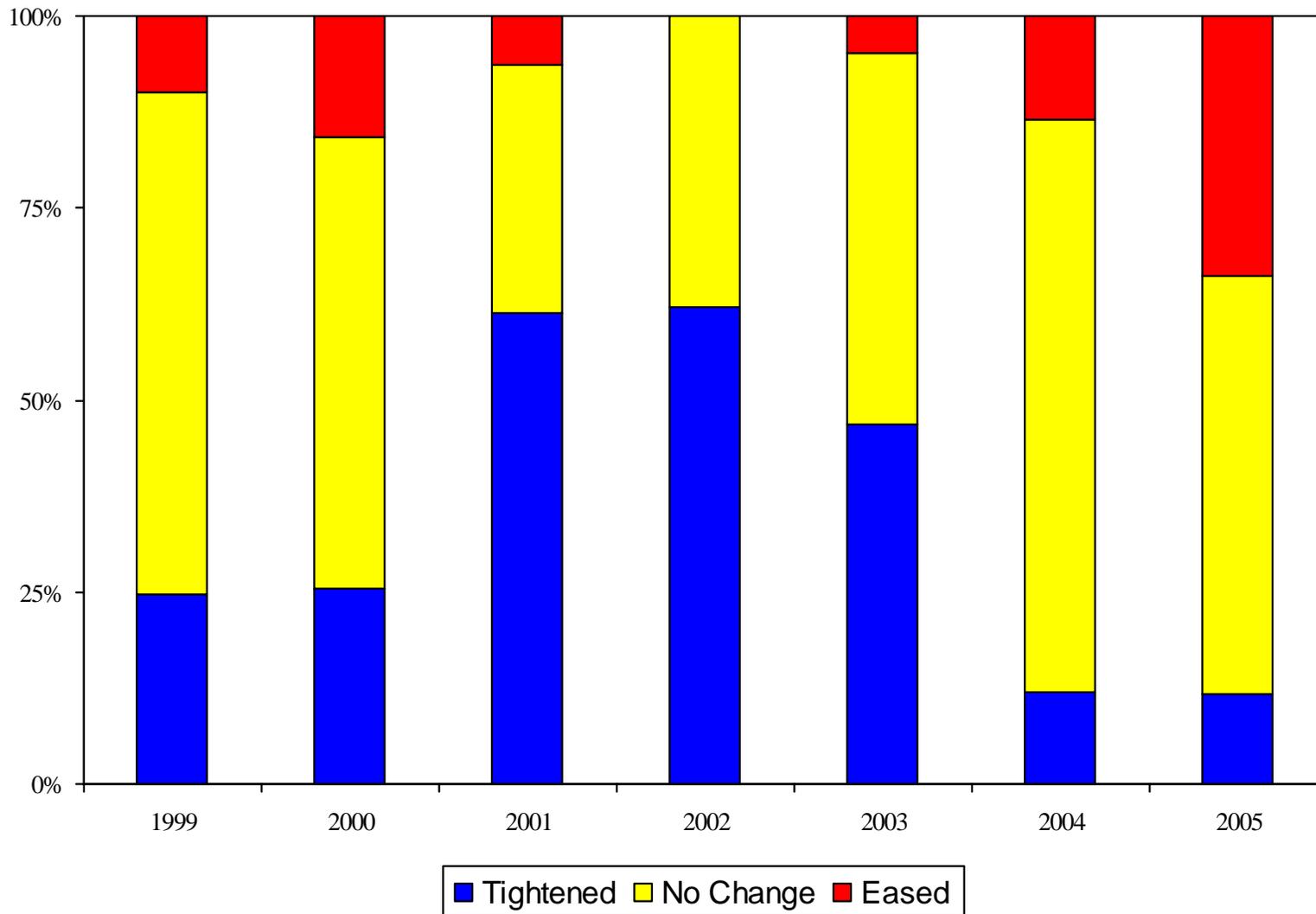
Because reduced payment requirements and extended amortization arrangements can mask credit risk, bankers need to develop broader, more discerning, and more forward looking approaches to measuring and monitoring risk in retail portfolios. Bankers should refer to the guidelines contained in OCC Bulletin 2005-3, “Standards for National Banks’ Residential Mortgage Lending Practices,” OCC Bulletin 2005-22, “Home Equity Lending — Credit Risk Management Guidance,” and the updated “Retail Lending Examination Procedures,” in the *Comptroller's Handbook* series issued in December 2004. For commercial portfolios, bankers are directed to OCC Advisory Letter 1999-4, “Leveraged Lending.”

The OCC will continue to focus supervisory attention and resources to ensuring that credit risk in national banks is appropriately identified and effectively managed.

Part II: Graphs and Tables

Underwriting Trends for Commercial Credits

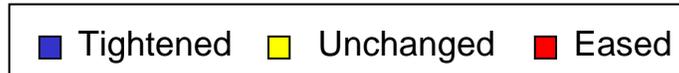
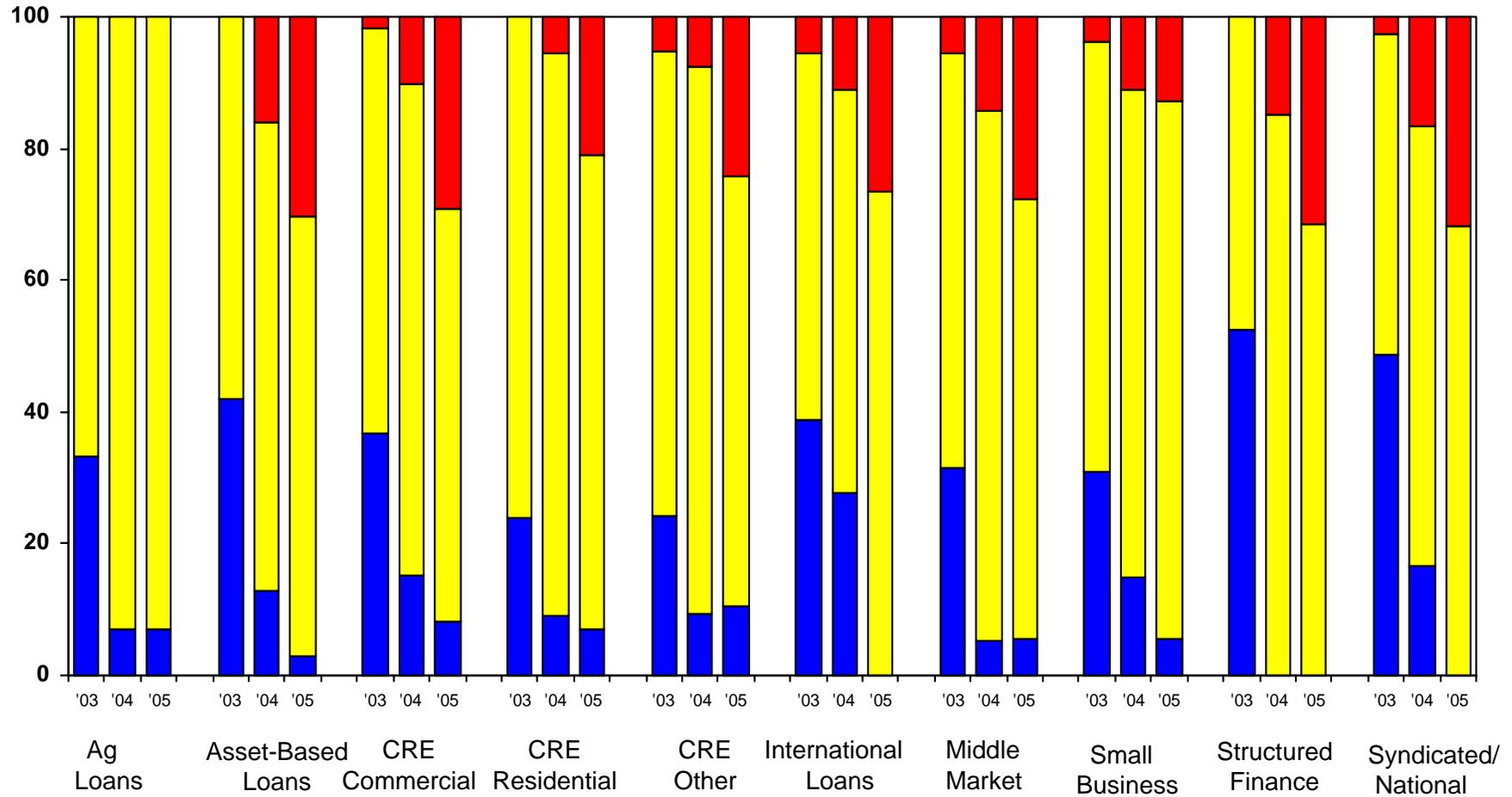
Percent of Banks



Commercial Underwriting Trends

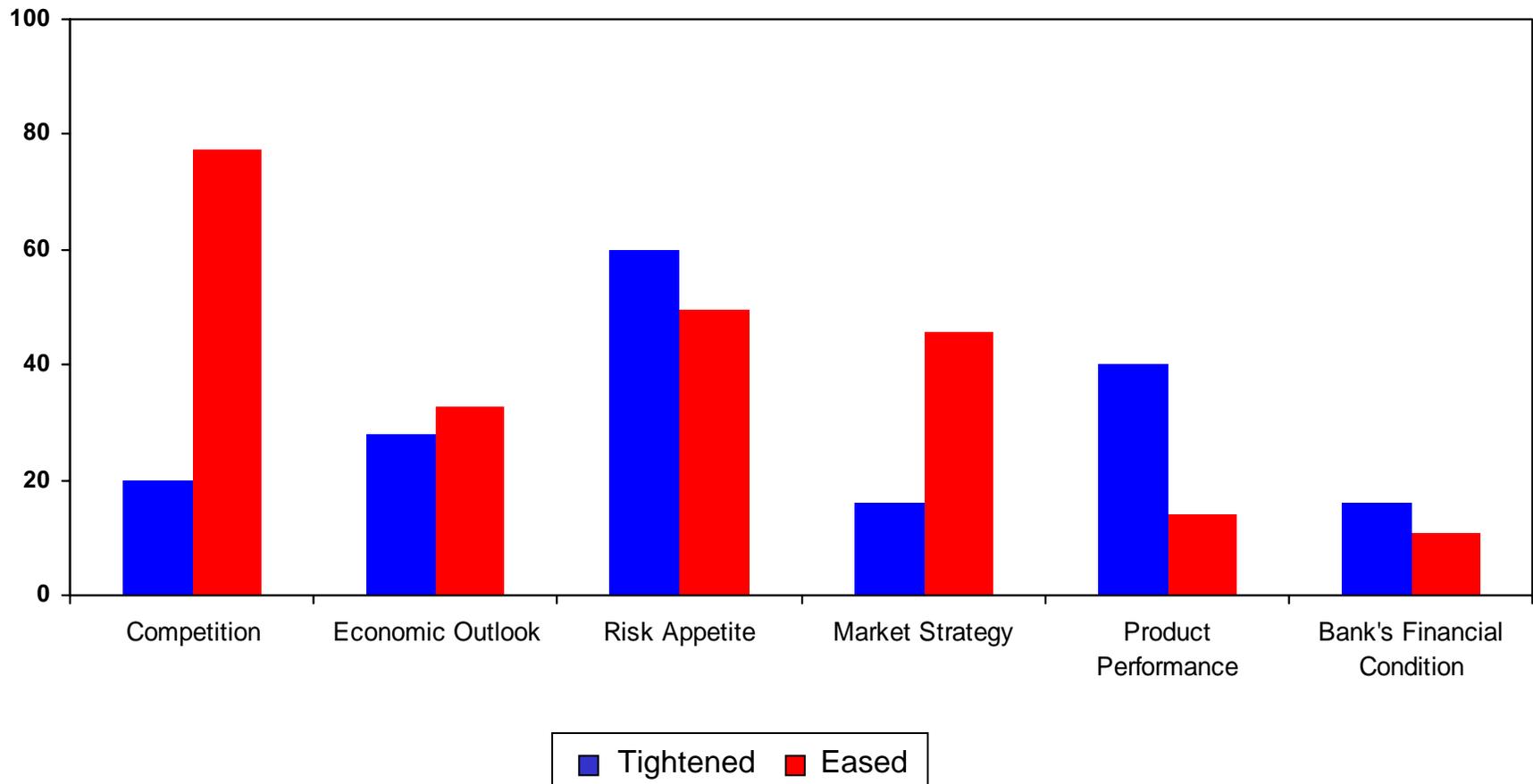
By Product Type

Percent of Banks



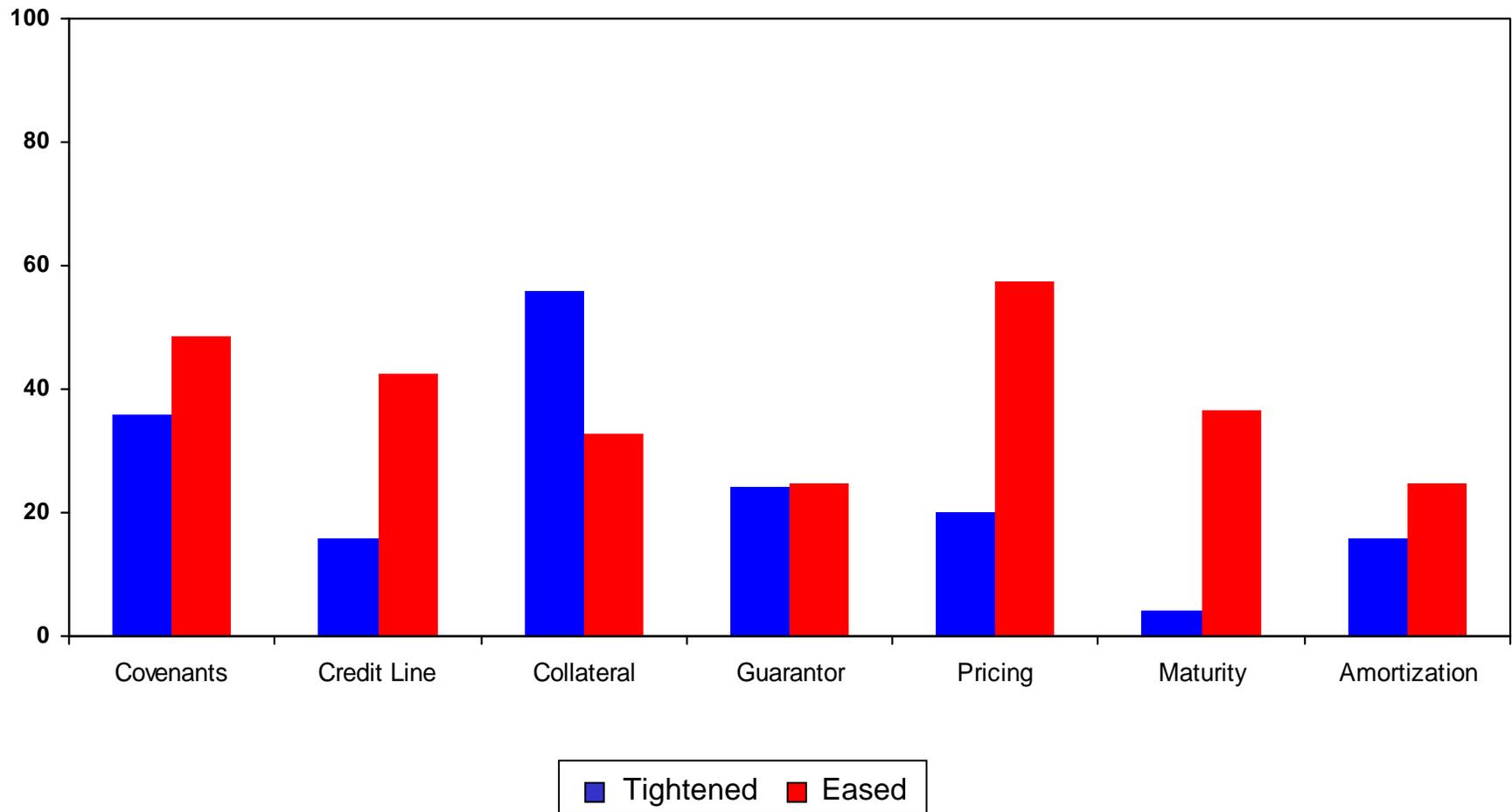
Reasons for Changing Commercial Underwriting Standards

Percent of Banks



Methods Used to Change Commercial Underwriting Standards

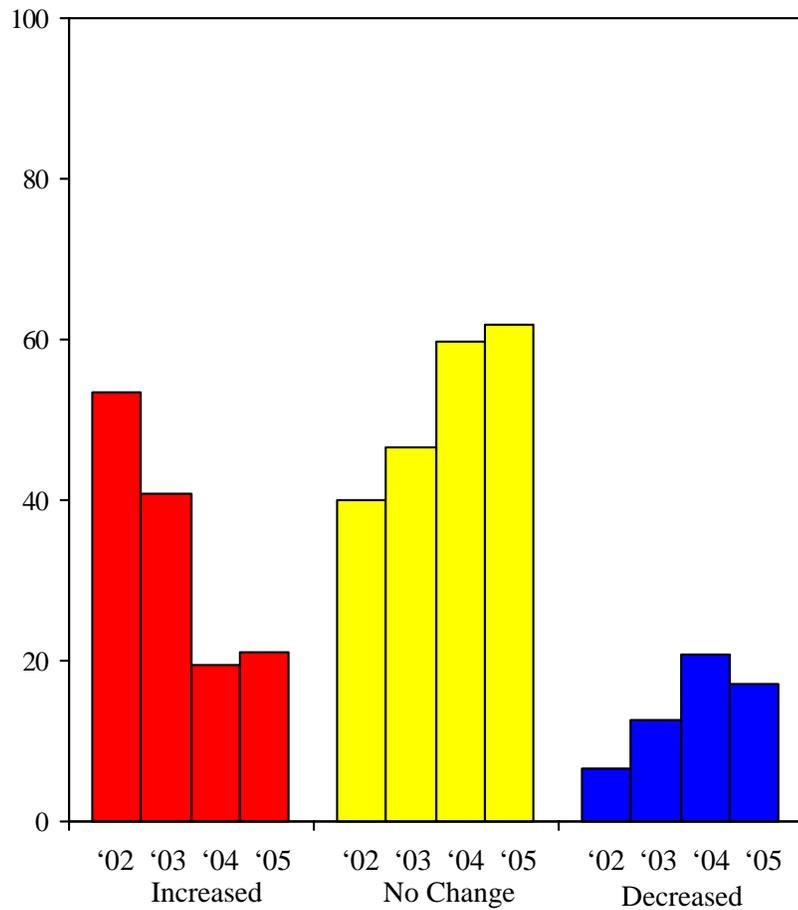
Percent of Banks



Commercial Credit Risk Trends

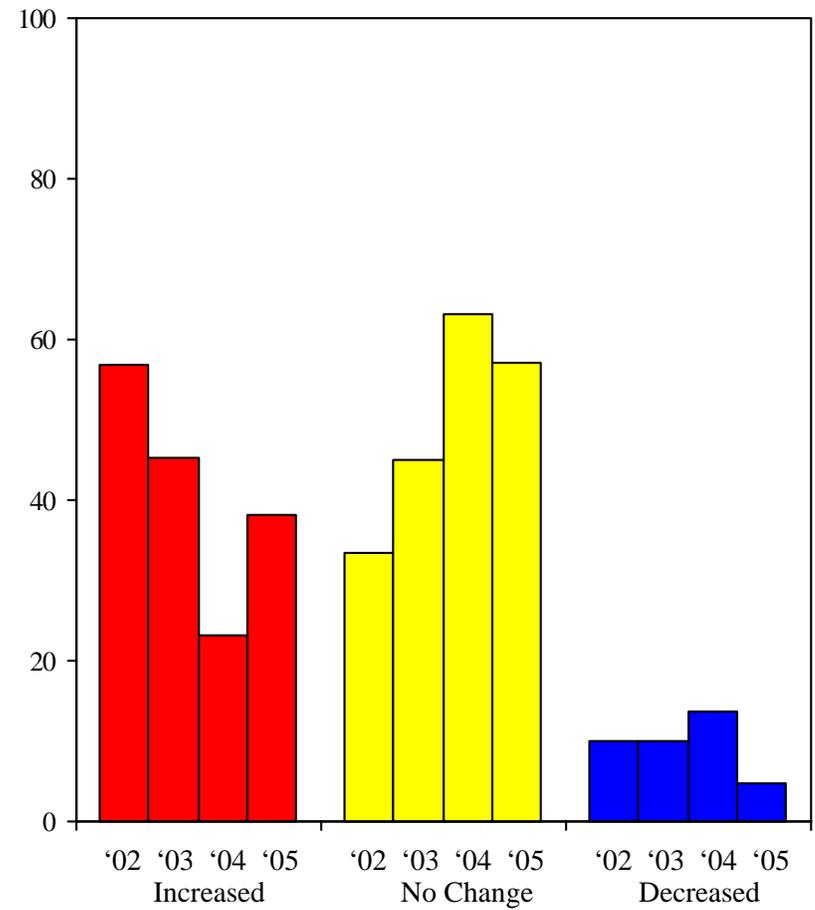
Past 12 Months

Percent of Banks



Next 12 Months

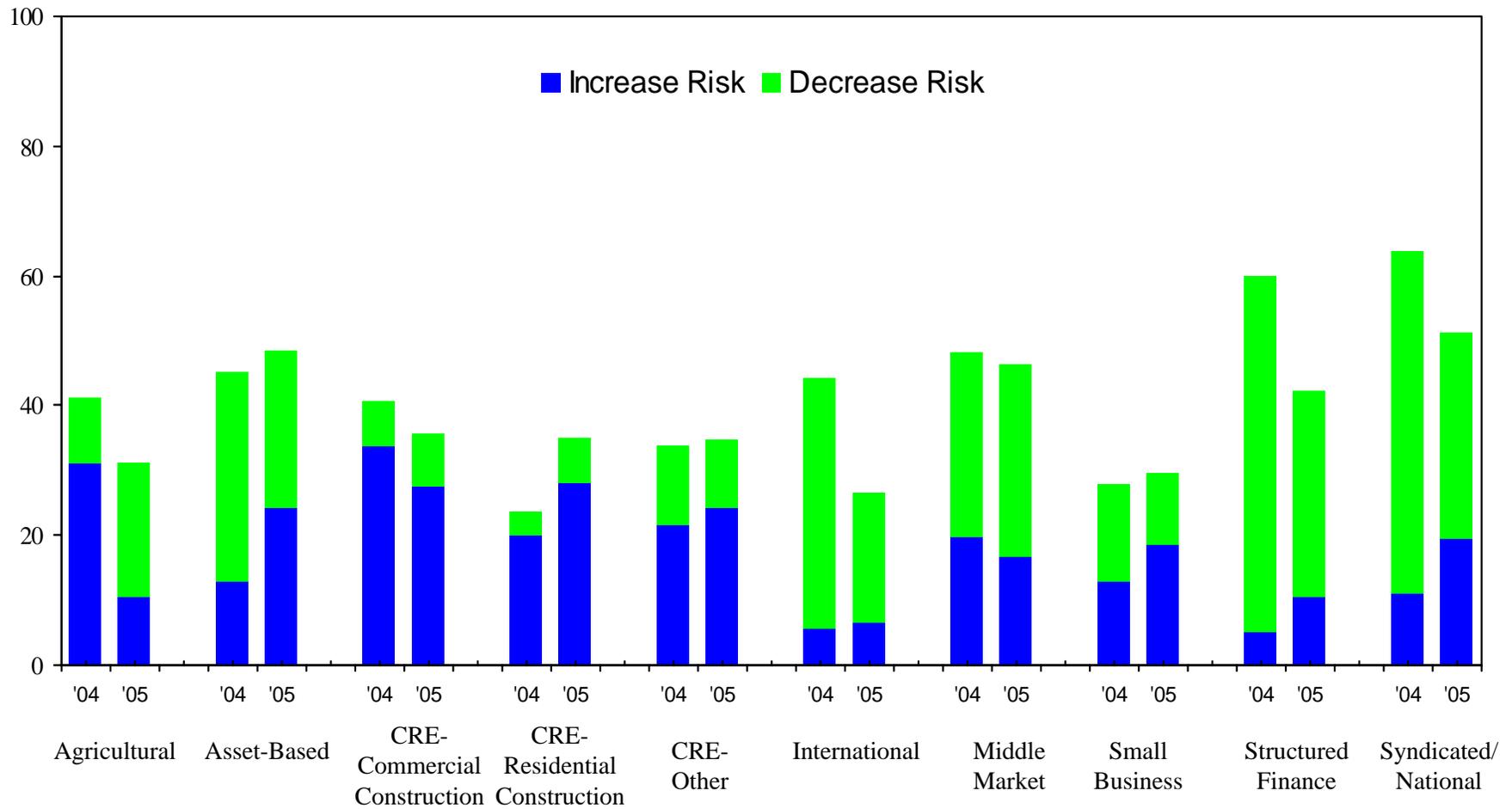
Percent of Banks



Commercial Credit Risk Trends

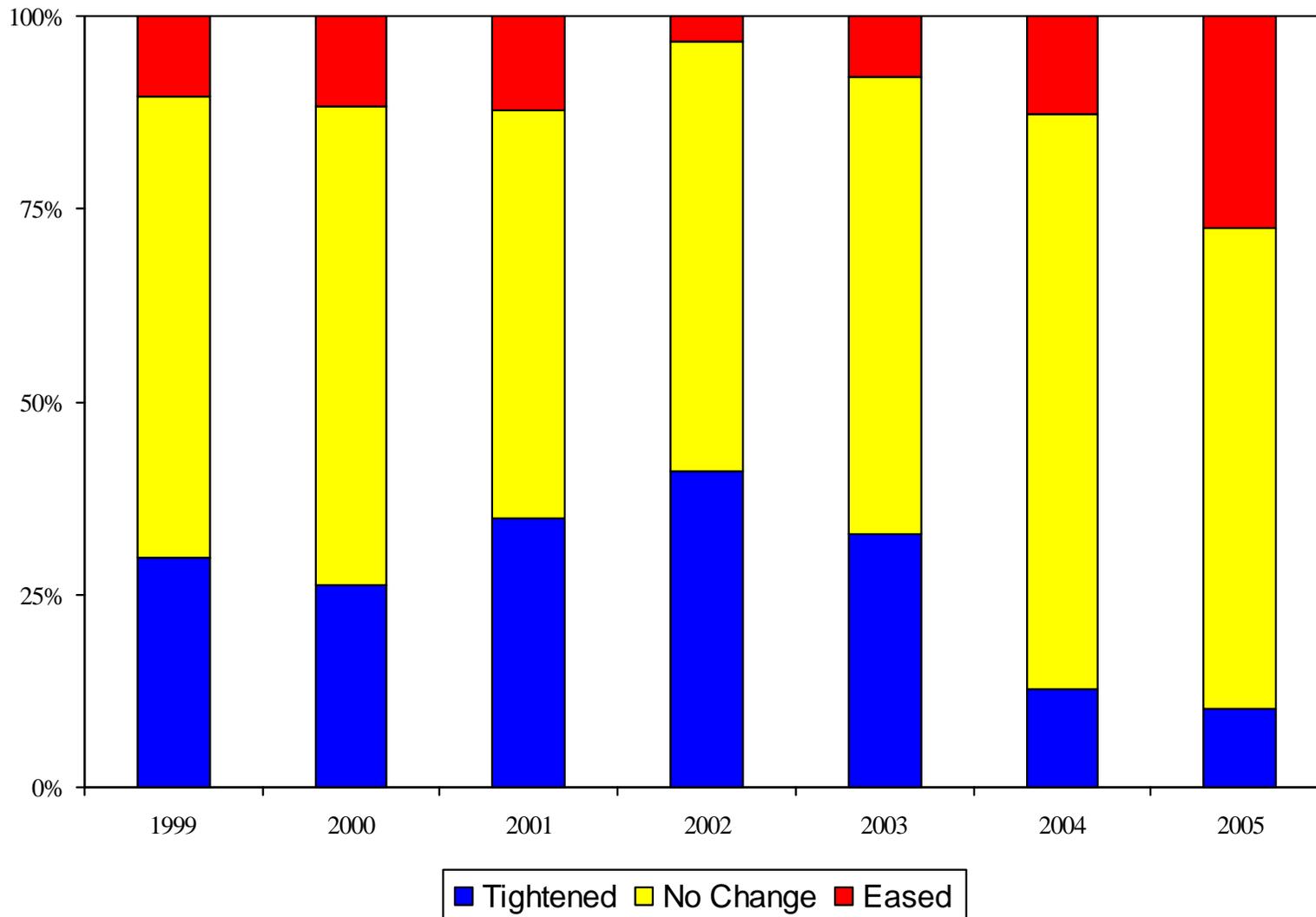
By Product Type

Percent of Banks



Underwriting Trends for Retail Credit

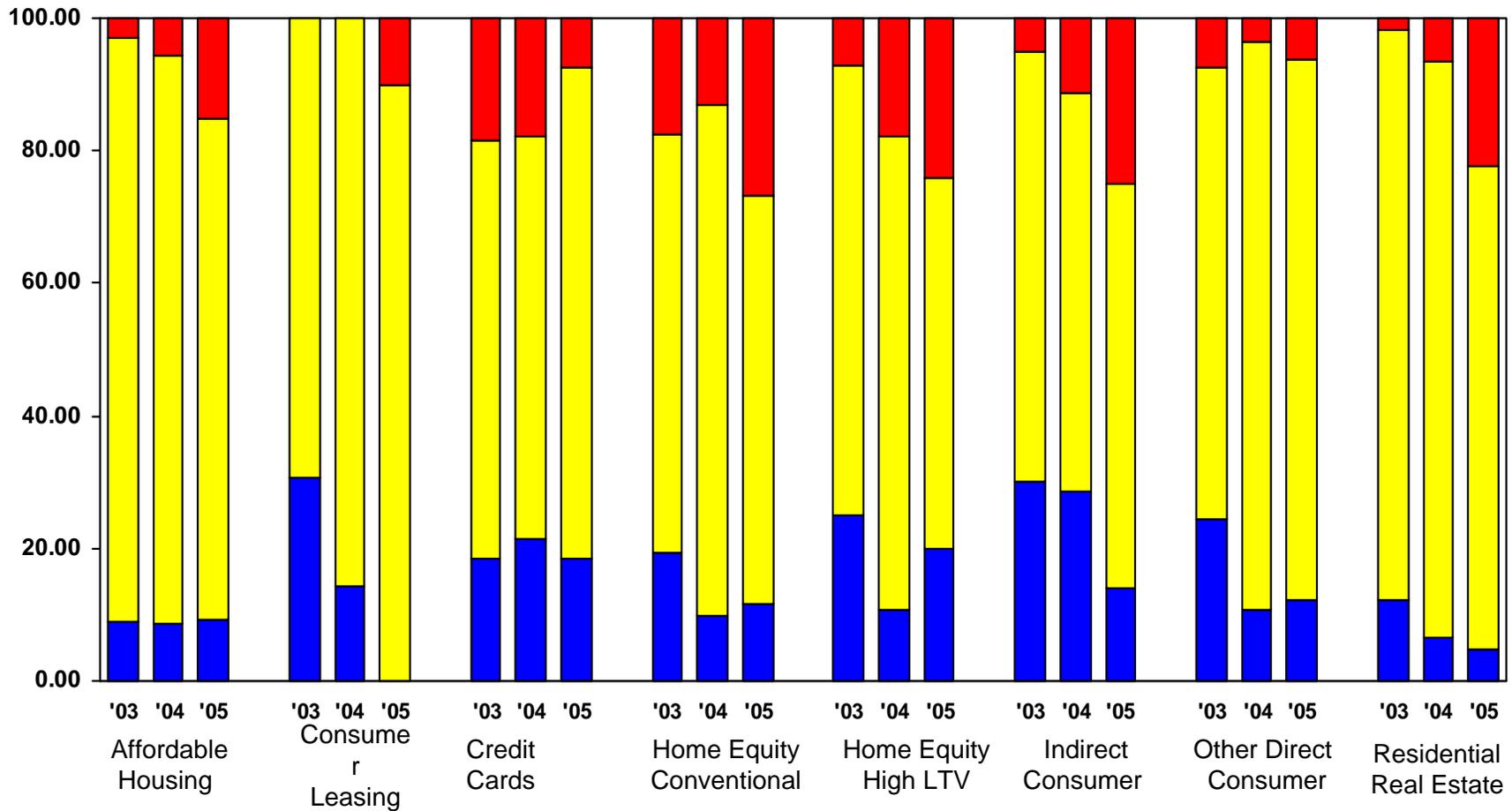
Percent of Banks



Retail Underwriting Trends

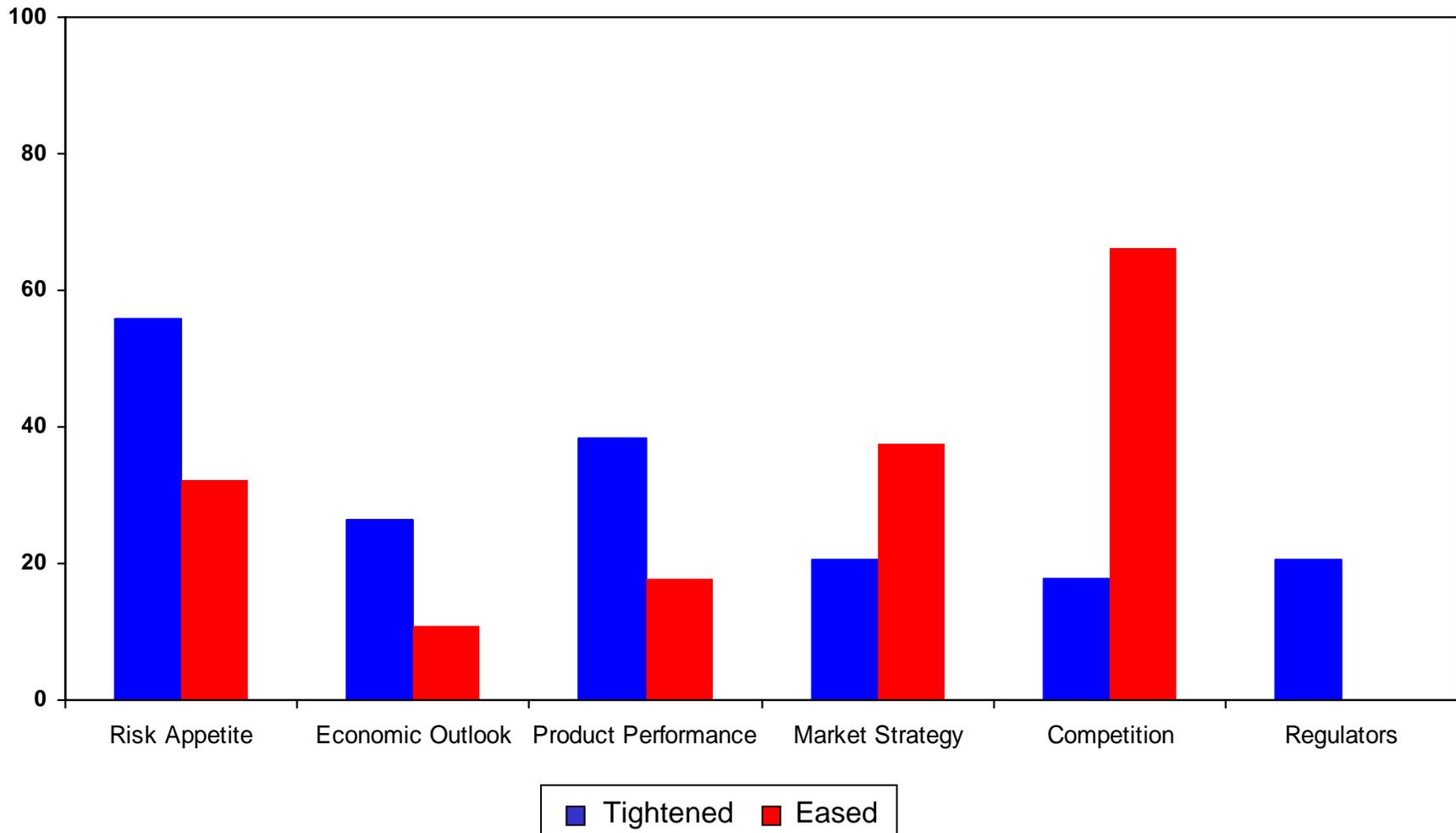
By Product Type

Percent of Banks



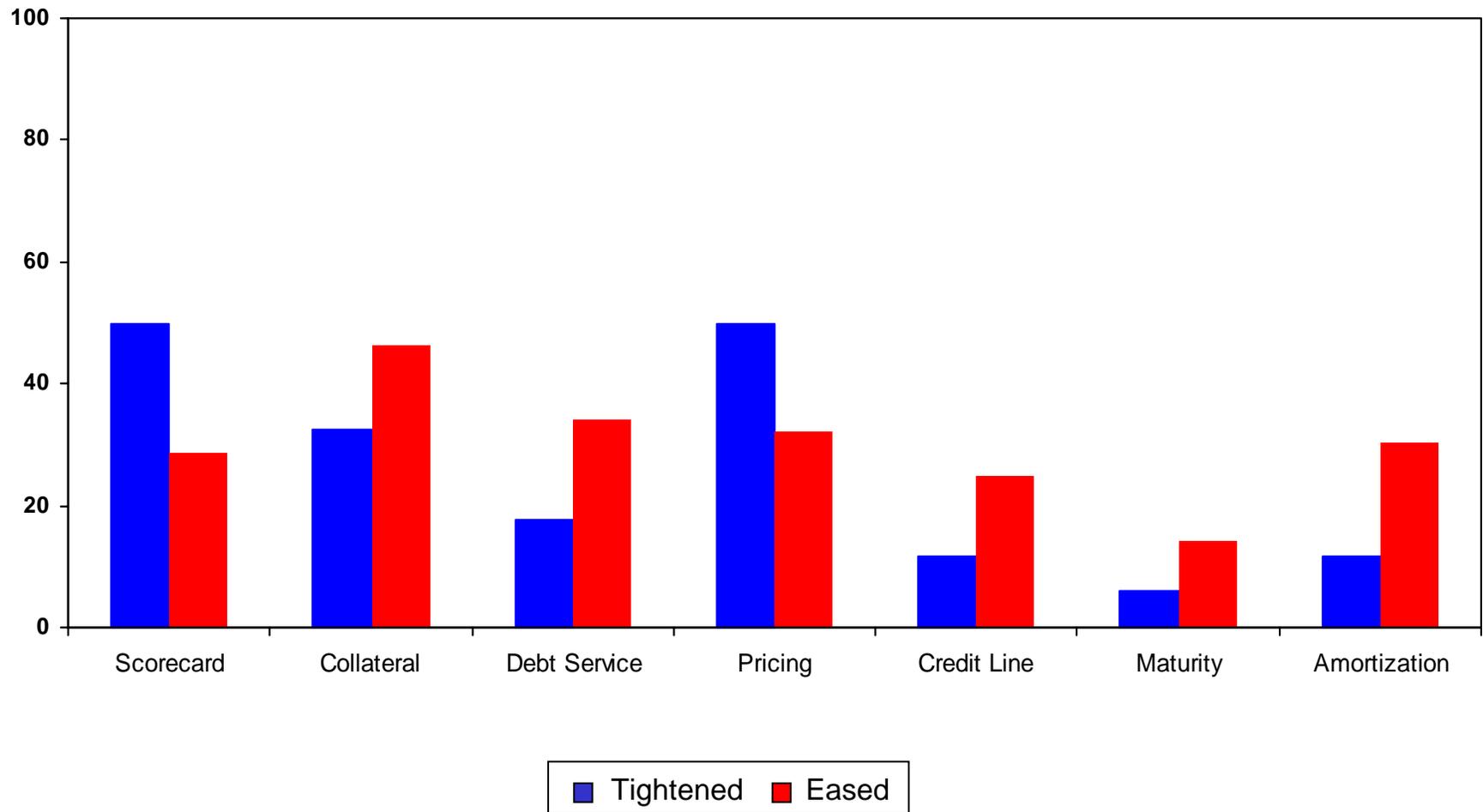
Reasons for Changing Retail Underwriting Standards

Percent of Banks



Methods Used to Change Retail Underwriting Standards

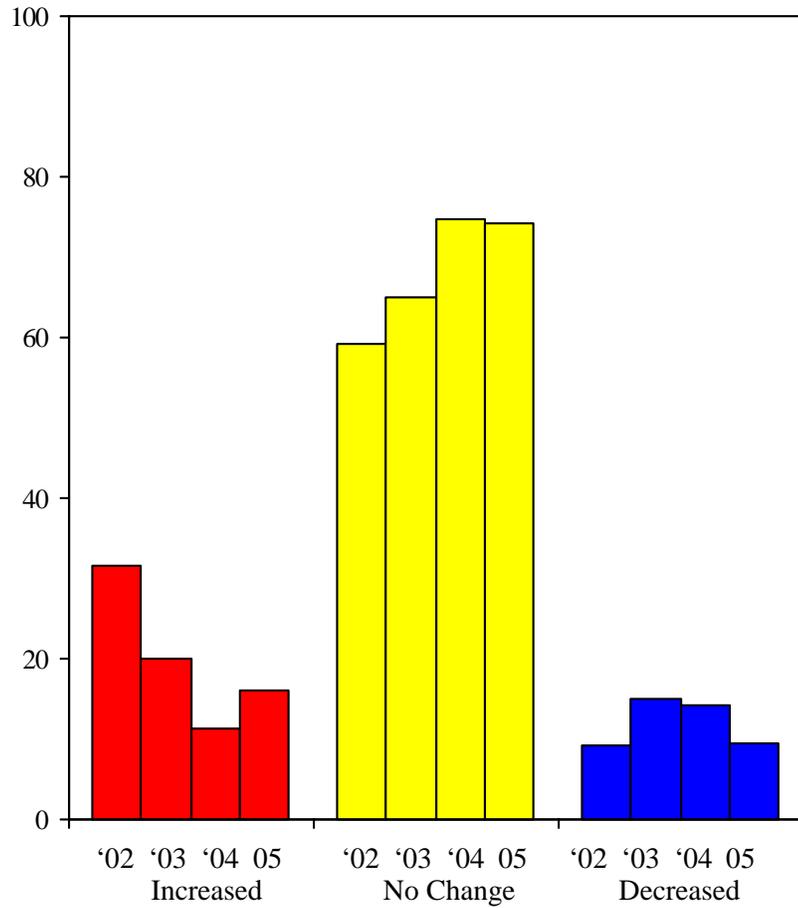
Percent of Banks



Retail Credit Risk Trends

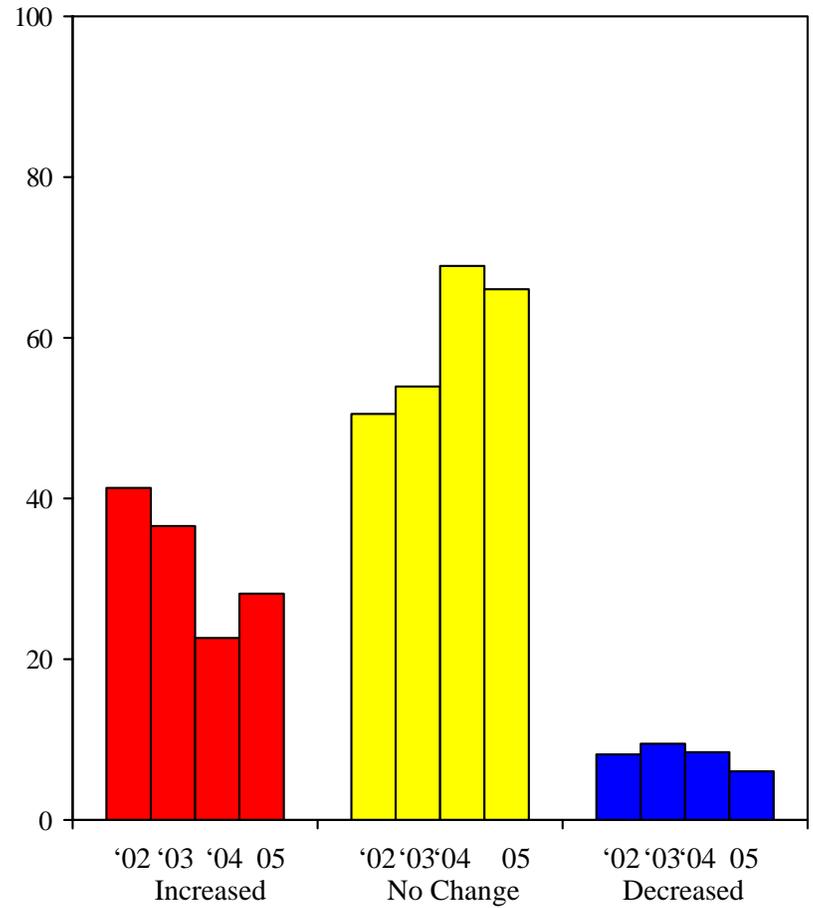
Past 12 Months

Percent of banks

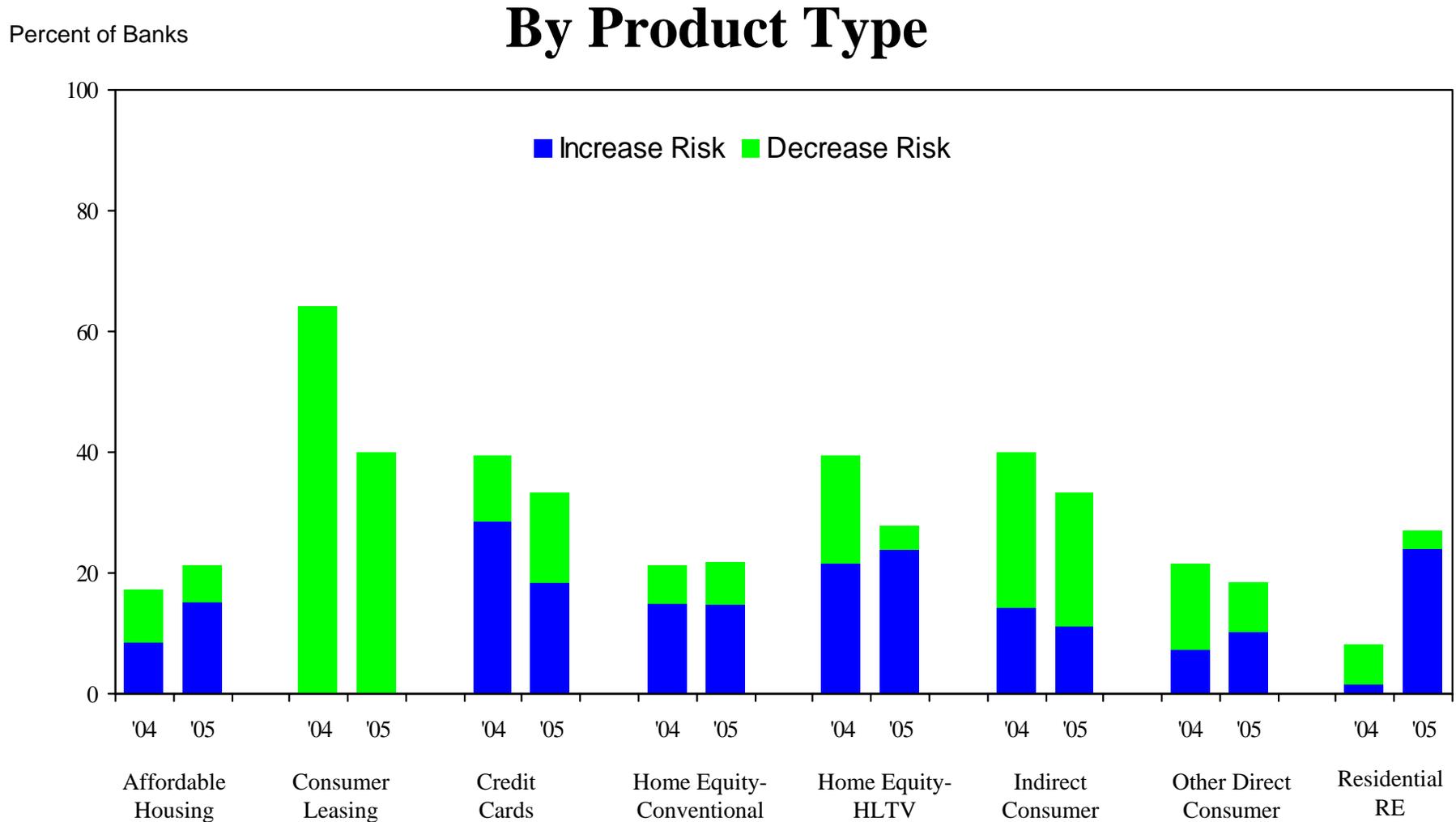


Next 12 Months

Percent of banks



Retail Credit Risk Trends



Commercial Lending Portfolios

Agricultural Lending

Twenty-eight of the 71 banks in the survey were engaged in some form of agricultural lending.

Changes in Underwriting Standards in Agricultural Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	3	79	18
2000	3	71	26
2001	3	71	26
2002	0	70	30
2003	0	67	33
2004	0	93	7
2005	0	93	7

Changes in the Level of Credit Risk in Agricultural Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	6	42	49	3
2000	0	15	41	44	0
2001	0	17	43	34	6
2002	0	7	63	30	0
2003	0	11	48	41	0
2004	0	10	59	31	0
2005	4	17	69	10	0
Future 12 Months	0	7	79	14	0

Asset-Based Loans

Thirty-three of 71 banks in the survey were engaged in asset-based lending.

Changes in Underwriting Standards in Asset-Based Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	10	78	12
2000	11	67	22
2001	5	53	42
2002	3	66	31
2003	0	58	42
2004	16	71	13
2005	30	67	3

Changes in the Level of Credit Risk in Asset-Based Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	10	66	24	0
2000	0	8	62	30	0
2001	5	8	42	45	0
2002	0	0	50	50	0
2003	3	26	42	29	0
2004	3	29	55	13	0
2005	0	24	52	24	0
Future 12 Months	0	3	55	42	0

Commercial Real Estate Lending — Commercial Construction

Sixty-three of the 71 banks in the survey were engaged in commercial construction lending.

Changes in Underwriting Standards in Commercial Construction Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
2003	2	61	37
2004	10	75	15
2005	29	63	8

Changes in the Level of Credit Risk in Commercial Construction Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
2003	0	7	46	42	5
2004	0	7	59	34	0
2005	2	6	65	27	0
Future 12 Months	0	5	60	35	0

Commercial Real Estate Lending — Residential Construction

Fifty-seven of the 71 banks in the survey were engaged in residential construction lending.

Changes in Underwriting Standards in Residential Construction Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
2003	0	76	24
2004	5	86	9
2005	21	72	7

Changes in the Level of Credit Risk in Residential Construction Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
2003	0	2	62	34	2
2004	0	4	76	18	2
2005	2	5	65	28	0
Future 12 Months	0	4	49	47	0

Commercial Real Estate Lending — Other

Sixty-six of the 71 banks in the survey were engaged in other commercial real estate lending.

Changes in Underwriting Standards in Other Commercial Real Estate Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
2003	5	71	24
2004	8	83	9
2005	24	65	11

Changes in the Level of Credit Risk in Other Commercial Real Estate Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
2003	0	5	48	43	4
2004	0	12	66	20	2
2005	2	9	65	24	0
Future 12 Months	0	3	55	42	0

International Lending

Fifteen of the 71 banks in the survey were active in international lending.

Changes in Underwriting Standards in International Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	4	54	42
2000	14	72	14
2001	29	57	14
2002	11	61	28
2003	6	55	39
2004	11	61	28
2005	27	73	0

Changes in the Level of Credit Risk in International Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	8	8	42	38	4
2000	0	33	53	14	0
2001	0	14	53	33	0
2002	0	22	39	28	11
2003	0	6	55	33	6
2004	6	33	55	6	0
2005	0	20	73	7	0
Future 12 Months	0	0	67	33	0

Middle Market Lending

Fifty-five of the 71 banks in the survey were engaged in middle market lending.

Changes in Underwriting Standards in Middle Market Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	18	73	9
2000	18	66	16
2001	11	48	41
2002	0	60	40
2003	6	63	31
2004	14	81	5
2005	28	67	5

Changes in the Level of Credit Risk in Middle Market Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	8	56	36	0
2000	0	2	50	46	2
2001	0	2	35	59	4
2002	2	8	22	66	2
2003	0	13	39	44	4
2004	0	28	52	18	2
2005	4	26	54	16	0
Future 12 Months	0	9	46	45	0

Small Business Lending

Fifty-five of the 71 banks in the survey are lending in the small business market.

Changes in Underwriting Standards in Small Business Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	13	75	12
2000	8	73	19
2001	5	63	32
2002	2	66	32
2003	4	65	31
2004	11	74	15
2005	13	81	6

Changes in the Level of Credit Risk in Small Business Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	8	67	23	2
2000	0	3	72	22	3
2001	0	3	60	37	0
2002	0	2	56	40	2
2003	0	4	56	38	2
2004	0	15	72	13	0
2005	0	11	70	19	0
Future 12 Months	0	4	63	33	0

Structured Finance

Eighteen of the 71 banks in the survey provided structured finance loans.

Changes in Underwriting Standards in Structured Finance Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	24	44	32
2000	35	45	20
2001	0	4	96
2002	0	44	56
2003	0	48	52
2004	15	85	0
2005	32	68	0

Changes in the Level of Credit Risk in Structured Finance Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	4	36	56	4
2000	0	0	20	80	0
2001	0	4	8	46	42
2002	0	7	26	52	15
2003	10	33	28	29	0
2004	15	40	40	5	0
2005	5	27	58	5	5
Future 12 Months	0	5	63	32	0

Syndicated/National Credits

Forty-one of the 71 banks in the survey were active in the syndicated/national credit market.

Changes in Underwriting Standards in Syndicated/National Credit Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	18	50	32
2000	22	61	17
2001	0	34	66
2002	0	45	55
2003	3	49	48
2004	17	66	17
2005	32	68	0

Changes in the Level of Credit Risk in Syndicated/National Credit Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	0	45	45	10
2000	0	0	36	61	3
2001	0	6	17	63	14
2002	0	8	29	53	10
2003	5	27	33	30	5
2004	17	36	36	11	0
2005	5	27	49	19	0
Future 12 Months	0	5	56	39	0

Retail Lending Portfolios

Affordable Housing Lending

For the purposes of this survey, affordable housing loans included all types of loans on affordable housing for low- and moderate-income individuals and families, including single- to four-family and multifamily dwellings. Thirty-three of the 71 banks in the survey were reported to be making affordable housing loans.

Changes in Underwriting Standards in Affordable Housing Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	16	70	14
2000	10	84	6
2001	6	88	6
2002	3	91	6
2003	3	88	9
2004	6	86	8
2005	15	76	9

Changes in the Level of Credit Risk in Affordable Housing Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	2	2	78	18	0
2000	0	6	83	11	0
2001	2	2	88	8	0
2002	0	6	73	21	0
2003	0	9	76	15	0
2004	0	9	82	9	0
2005	0	6	79	15	0
Future 12 Months	0	3	67	30	0

Consumer Leasing

Consumer leasing was offered by twelve of the 71 banks in the survey.

Changes in Underwriting Standards in Consumer Leasing Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	5	54	41
2000	0	50	50
2001	0	56	44
2002	0	67	33
2003	0	69	31
2004	0	86	14
2005	10	90	0

Changes in the Level of Credit Risk in Consumer Leasing Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	5	50	45	0
2000	0	5	67	28	0
2001	6	11	39	44	0
2002	7	13	26	47	7
2003	8	15	69	8	0
2004	43	21	36	0	0
2005	10	30	60	0	0
Future 12 Months	0	20	70	10	0

Credit Card Lending

Twenty-seven of the 71 banks in the survey banks were engaged in credit card lending.

Changes in Underwriting Standards in Credit Card Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	8	66	26
2000	9	75	16
2001	16	60	24
2002	12	66	22
2003	19	62	19
2004	18	61	21
2005	7	74	19

Changes in the Level of Credit Risk in Credit Card Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	13	47	36	4
2000	0	16	66	16	2
2001	8	5	57	27	3
2002	0	6	54	31	9
2003	0	22	48	30	0
2004	0	11	61	25	3
2005	0	15	67	18	0
Future 12 Months	0	0	74	26	0

Direct Consumer Lending

Fifty of the 71 banks in the survey were engaged in direct consumer lending.

Changes in Underwriting Standards in Other Direct Consumer Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	7	74	19
2000	10	78	12
2001	7	73	20
2002	2	67	31
2003	8	68	24
2004	3	86	11
2005	6	82	12

Changes in the Level of Credit Risk in Other Direct Consumer Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	7	65	28	0
2000	0	9	74	15	2
2001	0	7	71	20	2
2002	2	6	67	25	0
2003	2	17	72	7	2
2004	2	13	78	7	0
2005	0	8	82	10	0
Future 12 Months	0	8	80	12	0

Home Equity — Conventional Lending

Sixty of the 71 banks in the survey offered the conventional home equity lending product.

Changes in Underwriting Standards in Home Equity — Conventional Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	23	67	10
2000	23	64	13
2001	7	70	23
2002	0	74	26
2003	18	63	19
2004	13	77	10
2005	27	62	11

Changes in the Level of Credit Risk in Home Equity — Conventional Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	0	69	29	2
2000	0	5	73	20	2
2001	0	11	74	13	2
2002	0	7	71	22	0
2003	4	4	69	23	0
2004	0	6	79	13	2
2005	0	7	78	15	0
Future 12 Months	0	2	58	40	0

Home Equity — High Loan-to-Value (LTV) Lending

Twenty-five of the 71 banks in the survey offered the high LTV home equity lending product.

Changes in Underwriting Standards in Home Equity — High LTV Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	20	61	19
2000	21	55	24
2001	11	54	35
2002	0	56	44
2003	7	68	25
2004	18	71	11
2005	24	56	20

Changes in the Level of Credit Risk in Home Equity — High LTV Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	0	6	47	44	3
2000	0	13	58	24	5
2001	5	11	62	16	6
2002	0	12	40	44	4
2003	0	11	50	36	3
2004	0	18	61	18	3
2005	0	4	72	24	0
Future 12 Months	0	0	60	40	0

Indirect Consumer Lending

Thirty-six of the 71 banks in the survey were engaged in indirect consumer lending.

Changes in Underwriting Standards in Indirect Consumer Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	7	56	37
2000	7	60	33
2001	7	63	30
2002	0	72	28
2003	5	65	30
2004	11	60	29
2005	25	61	14

Changes in the Level of Credit Risk in Indirect Consumer Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	2	23	42	33	0
2000	7	16	55	22	0
2001	2	21	39	33	5
2002	3	13	38	43	3
2003	5	20	47	28	0
2004	0	26	60	14	0
2005	3	19	67	8	3
Future 12 Months	6	22	44	28	0

Residential Real Estate Lending

Sixty-three of the 71 banks in the survey were engaged in residential real estate lending.

Changes in Underwriting Standards in Residential Real Estate Loan Portfolios (Percent of Banks)

	Eased	Unchanged	Tightened
1999	14	77	9
2000	7	85	8
2001	12	72	16
2002	4	83	13
2003	2	86	12
2004	7	86	7
2005	22	73	5

Changes in the Level of Credit Risk in Residential Real Estate Loan Portfolios (Percent of Banks)

	Declined Significantly	Declined Somewhat	Unchanged	Increased Somewhat	Increased Significantly
1999	3	5	71	21	0
2000	0	3	83	12	2
2001	0	9	76	15	0
2002	0	8	68	24	0
2003	0	12	74	12	2
2004	0	6	92	2	0
2005	0	3	73	24	0
Future 12 Months	0	0	73	27	0