BANK AND NONBANK LENDING OVER THE PAST 70 YEARS

Introduction

In recent years, some banking activities and their inherent risks have migrated from banks to nonbanks. While banks have increased their share of outstanding loans since the financial crisis, a significant portion of residential mortgage lending and leveraged lending has migrated out of banks. Government-sponsored enterprises (GSEs) loosened their residential mortgage underwriting criteria, and nonbanks markedly increased their residential mortgage origination and servicing, which may increase risks to the financial system.

Banks' origination and distribution to nonbanks of a large volume of covenant-lite leveraged loans also have the potential to create unexpected vulnerabilities during a downturn. Competition between banks and nonbank financial companies may affect lending standards and strategies. Banks also have nonbank financial companies as customers, and this may expose banks to risk in many ways.

The FDIC continues to study the changing nature of the lending market and specific sectors, how banks are responding to the growth of nonbank lenders in certain lending areas, and the implications of these potential risks for the banking sector and the economy. This article provides an overview of broad trends in lending markets. The first two sections describe the lenders that are active in the market and summarize lending from 1952 to 2018. The last three sections discuss bank and nonbank lending in specific lending markets. Accompanying articles discuss residential mortgage lending and corporate debt in more detail.

Types of Lenders and Loan Holders

Many types of companies lend money, and some companies fund lending markets by purchasing loans. Some companies, like banks and credit unions, originate loans and either hold them on their balance sheets as assets or sell them to other investors. Other businesses, such as nonbank mortgage lenders and other finance companies, tend to have more limited balance sheet capacity and generally follow an originate-to-distribute model. These institutions originate loans to sell them immediately to investors. Other investors—like life insurance companies and some issuers of asset-backed securities (ABS)—do not originate many loans but purchase existing loans from originators. Life insurance companies purchase loans to hold as assets, while issuers of ABS buy and bundle the loans into securities, which they sell to investors.

In this article, loan holders are grouped according to Federal Reserve Flow of Funds categories. The main categories are banks, credit unions, GSEs, issuers of ABS, other financial companies, and nonfinancial companies. We separate banks and credit unions because their business lines and strategies differ in some ways. GSEs are federally chartered corporations: Fannie Mae, Freddie Mac, Federal Home Loan Banks, Farmer Mac, and the Farm Credit System, following the definitions in the Flow of Funds for GSEs and agency- and GSE-backed mortgage pools, unless otherwise noted. Ginnie Mae is wholly owned by the federal government and guarantees mortgage-backed securities (MBS) backed by mortgages that are insured by federal agencies.[1] Other financial companies include entities like finance companies, which make loans to hold or to sell; insurance companies, which tend to purchase loans as assets; and issuers of ABS, which purchase loans to securitize them.[2] The nonfinancial group includes the government, nonprofits, nonfinancial businesses, and households, and all of these hold loans as assets.

[1] We combine the categories of GSEs and agency- and GSE-backed mortgage pools because Financial Accounting Standards Board Statements No. 166 and No. 167 resulted in the consolidation of a large amount of securitized loan balances back onto lender balance sheets in first quarter 2010. Ginnie Mae mortgage pools are classified as agency- and GSE-backed mortgage pools.

[2] The complete list of other financial companies is monetary authority, property-casualty insurance company, life insurance company, private pension fund, federal government retirement fund, state or local government retirement fund, mutual fund, ABS issuer, finance company, real estate investment trust, broker-dealer, holding company, and funding corporation.

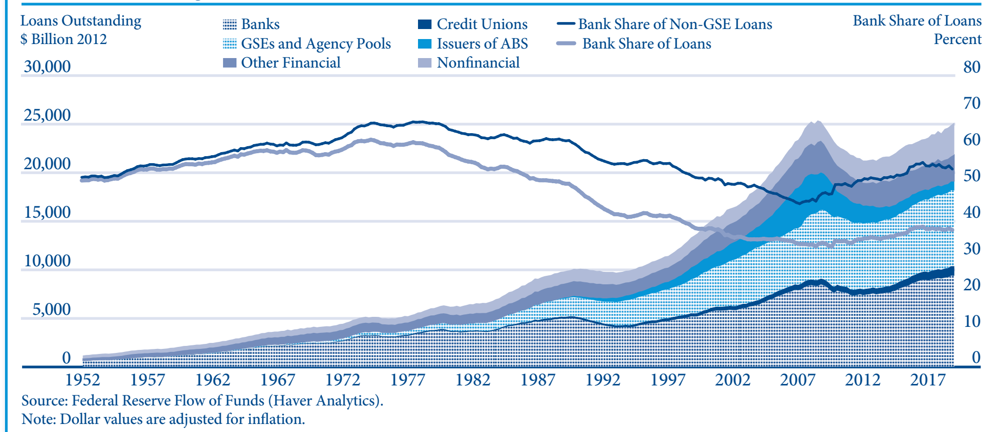
Historic Perspective of the Lending Market

Total lending has grown dramatically since the 1950s, with the largest growth in loan holdings in banks and the GSEs (Chart 1). The bank share peaked at 62 percent in 1974. It then fell fairly consistently and bottomed out in fourth quarter 2009 at 32 percent. Over the same period, corporations also shifted toward market-based financing and issued debt securities like bonds and commercial paper. Debt securities are a significantly larger portion of nonfinancial corporations' overall debt obligations than they were in past decades. Since 2008, the bank share of loans outstanding has increased modestly and has stabilized around 37 percent since first quarter 2016. In 2018, the total of corporate debt securities outstanding was about twice the sum of corporate bank loans and commercial mortgages.

The shifts in bank lending also reflect the growth of nonbank loan holders, primarily in the mortgage market. GSEs hold an increasing share of residential mortgages. The growth of mortgage securitization played a major role in the shift (see accompanying article, "Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period"). GSEs were created to serve as a secondary market for residential mortgages by purchasing mortgages from originators.[3] This allowed originators to make more loans. In the 1970s, Fannie Mae and Freddie Mac began securitizing the mortgages they had purchased into MBS, which contributed to the growth of the secondary market for mortgages. The rise of securitization enabled a broader range of investors to fund the mortgage market, generating growth in mortgages held by the GSEs. In second quarter 2019, the GSEs held about 31 percent of all loans outstanding. From the 1980s to about 2005, the bank share of non-GSE loans fell and then recovered, with a more pronounced rebound since the financial crisis that started in 2007.

Chart 1

The Bank Share of Loans Fell in the 1980s and 1990s as Securitization Developed, but Started Rising After 2009



Source: Federal Reserve Flow of Funds (Haver Analytics).
Note: Dollar values are adjusted for inflation.

Lending Trends by Sector

Nonbank lending also plays an important role over time in other markets. Except for leveraged loans, the bank shares of loans outstanding have been generally stable or increasing since 2010. Pre-financial crisis, bank shares of outstanding loans in several categories declined. In 1–4 family mortgage lending, bank shares decreased from 40 percent in 1990 to 25 percent in 2010, and in multifamily residential mortgages, from 44 percent in 1990 to 29 percent in 2010. As shown in the table on the following page, bank shares of commercial mortgages and agricultural loans grew over this period.

[3] For a history of the GSEs, see "A Brief History of the Housing Government-Sponsored Enterprises," Federal Housing Finance Agency Office of Inspector General, www.fhfaoig.gov/Content/Files/History%20of%20the%20Government%20Sponsored%20Enterprises.pdf, and "Our History," Farm Credit, https://farmcredit.com/history.

Many factors contributed to growth in the nonbank share of loans before the financial crisis, but the development and growth of loan securitization was an important one. Some investors prefer to or must hold rated, more-liquid securities like ABS rather than unrated, less-liquid assets such as loans. In the common securitization model, lenders originate loans and sell them to nonbanks that package the loans and issue ABS. Loan types with more standardized terms and more forecastable outcomes—like residential mortgages and some commercial real estate (CRE) mortgages—are easier to securitize, enabling greater participation by nonbanks that rely on an originate-to-distribute model. Securitization of other loan types—like large leveraged loans—involve pools with fewer but larger loans that are rated, which makes them more easily securitized. On the other hand, commercial and industrial loans tend to be smaller and more idiosyncratic than the larger leveraged loans, so they are generally not rated and have not been securitized to the same degree. The following sections describe the changes in different lending categories.

Bank Share of Loans by Type of Loan

	Bank Share of Loans Outstanding (%)			
Type of Loans	**1990**	**2000**	**2010**	**2018**
1–4 family mortgages	40	30	25	24
Leveraged loans	NA	25	8	3
CRE mortgages	50	49	47	50
Commercial mortgages	52	54	54	58
Multifamily residential mortgages	44	34	29	33
Consumer credit	52	35	45	42
Agriculture loans	35	46	39	42

Sources: Federal Reserve Flow of Funds (Haver Analytics), S&P Leveraged Commentary and Data, and USDA Economic Research Service.

Notes: Leveraged loans exclude revolving credit-only loans and left and right agent commitments (including administrative, syndication and documentation agent, and arranger). Data are as of the fourth quarter.

I. 1–4 Family Mortgages

One-to-four family mortgages, including home equity loans and home equity lines of credit, are loans that are secured by residential units. The share of 1–4 family mortgages outstanding held by banks declined dramatically from 74 percent in 1978 to 24 percent in second quarter 2019 as securitization of mortgages became an increasingly larger part of the market. From 1980 to 2000, the majority of MBS were issued by the GSEs, but private-label MBS (PLMBS) grew rapidly before the financial crisis.[4] Demand for PLMBS dried up during the financial crisis and remains well below pre-financial crisis levels, despite recent growth.[5] Government-backed MBS issuance, including GSE issuance, has continued to grow. In second quarter 2019, GSEs held 63 percent of residential mortgages outstanding.

Because of the demand for GSE MBS, both banks and nonbanks sell mortgages to the GSEs. Since the financial crisis, nonbanks have predominantly offered mortgages that conform to the criteria established by the GSEs, as nonbanks rely on an originate-to-distribute business model.[6] Banks are more likely to make jumbo and nonconforming loans that cannot be sold to the GSEs, and tend to hold more of their residential mortgages. As these banks retain the risk of the loans, they may perform more thorough underwriting than nonbank lenders who quickly sell their loans.

[4] PLMBS are MBS issued by private financial institutions. They are also called non-agency MBS.

[5] PLMBS issuance fell from $1.3 trillion in 2006 to $28 billion in 2012. As of second quarter 2019, private pools held $454 billion in residential mortgages, about 4 percent of the outstanding residential mortgages.

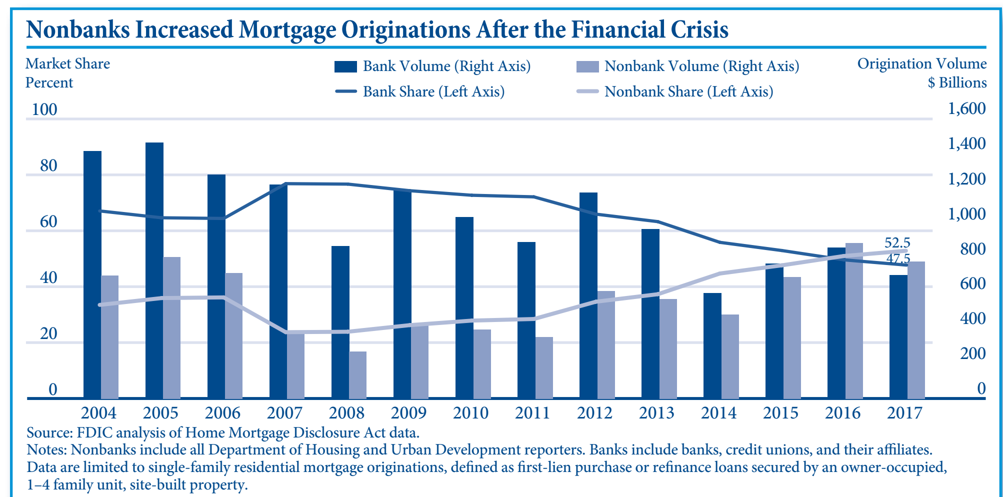
[6] These mortgages are known as conforming loans, since they conform to standards set by the GSEs and are eligible to be purchased by the GSEs.

In the early 2000s, bank and nonbank mortgage lenders loosened underwriting standards, and residential mortgage originations grew rapidly, partly driven by the demand for MBS. In the financial crisis that began in 2007, PLMBS issuance fell and many nonbank mortgage lenders failed or merged. The nonbank share of mortgage originations among Home Mortgage Disclosure Act (HMDA) report filers fell from 36 percent in 2006 to 24 percent in 2008 (Chart 2). After the financial crisis, new nonbank lenders entered the market, increasing from 820 lenders in 2011 to 919 in 2017. The number of bank mortgage lenders fell during that period. In 2017, nonbanks accounted for 53 percent of mortgages originated by HMDA filers.[7] Nonbanks originate a significant volume of loans for sale to GSEs. GSEs have loosened underwriting criteria in recent years, which could increase financial system vulnerability if pronounced housing market stress occurs (see accompanying article, "Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period").

Mortgage servicing also has shifted from banks to nonbanks. Nonbanks held 42 percent of mortgage servicing rights held by the top 25 servicers in 2018, up from 4 percent in 2008 and 38 percent in 2000. Large bank sales of financial crisis-era legacy servicing portfolios contributed to the shift in servicing from banks to nonbanks. Fines, legal fees, and other heightened expenses associated with litigation and with nonperforming loans in financial crisis-era servicing portfolios negatively affected profitability at some banks and may have deterred growth in servicing portfolios after the financial crisis.[8] Changes in the regulatory capital treatment of mortgage servicing assets may have contributed to the reduction in mortgage servicing rights by large banks.[9] Overall servicing volume rebounded to $10.9 trillion in 2018, only slightly below the peak of $11.2 trillion in 2007 and more than double the $5.1 trillion reported in 2000.[10]

Chart 2

Nonbanks Increased Mortgage Originations After the Financial Crisis



Source: FDIC analysis of Home Mortgage Disclosure Act data.
Notes: Nonbanks include all Department of Housing and Urban Development reporters. Banks include banks, credit unions, and their affiliates. Data are limited to single-family residential mortgage originations, defined as first-lien purchase or refinance loans secured by an owner-occupied, 1–4 family unit, site-built property.

[7] FDIC analysis of HMDA data. Bank mortgage lenders are banks that file HMDA reports.

[8] FDIC, Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), National Credit Union Administration (NCUA), "Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets," June 2016, pages 23–25, https://www.federalreserve.gov/publications/other-reports/files/effect-capital-rules-mortgage-servicing-assets-201606.pdf.

[9] FDIC, FRB, OCC, NCUA: 29–31.

[10] FDIC analysis of *Inside Mortgage Finance* data.

II. Corporate Debt and Leveraged Lending

Loans to corporations, including leveraged loans, have shifted out of banks over the past 60 years, and corporations have increased their use of debt securities to fund their businesses. Leveraged loans are syndicated loans made to below-investment-grade corporate borrowers.[11] Corporate debt securities include corporate bonds and commercial paper.

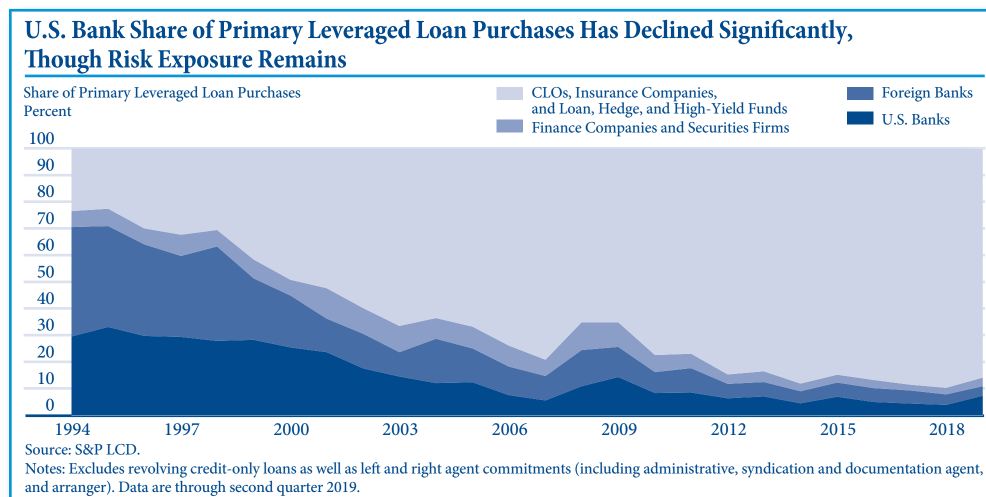
Institutional syndicated leveraged loans outstanding increased from $100 billion in 2000 to $1 trillion in 2018. Originations fell to $77 billion in 2009 but recovered to $625 billion in 2018. The share of primary leveraged loan purchases made by banks declined from 30 percent in 1994 to 3 percent in 2018 (Chart 3). Banks arrange almost all of the loans by providing information about the loan to investors and putting together a group of buyers. Banks often administer the loans. Of the top 20 leveraged loan administrative agents in the Leveraged Commentary and Data database for 2018, 18 were commercial banks or investment banks.

Over the past ten years, nonfinancial corporate debt securities grew from $4 trillion in first quarter 2009 to $6 trillion in first quarter 2019. Nonbank investors hold the majority of outstanding financial and nonfinancial corporate bonds. As of second quarter 2019, banks held only 3 percent of outstanding corporate bonds. Banks also underwrite corporate debt securities and provide other investment banking services.

Corporate debt has grown since 2008. Investors increased their demand for high-yielding leveraged loans and corporate debt securities, as they were willing to accept greater risk. To help satisfy the demand, underwriting standards deteriorated in this market and lenders issued loans to riskier corporations. The share of leveraged loans that lack strong covenants grew from near zero percent in the early 2000s, to 29 percent in 2007, and to 85 percent in 2018.[12] The leverage of the borrowers also increased over the same period.[13] Therefore,

Chart 3

U.S. Bank Share of Primary Leveraged Loan Purchases Has Declined Significantly, Though Risk Exposure Remains



Source: S&P LCD.
Notes: Excludes revolving credit-only loans as well as left and right agent commitments (including administrative, syndication and documentation agent, and arranger). Data are through second quarter 2019.

[11] Unless otherwise noted, we follow the S&P Global Market Intelligence Leveraged Commentary and Data definition of leveraged loans, which includes all syndicated loans that are below investment grade, are senior secured, and have a minimum spread of 125 basis points over LIBOR.

[12] Leveraged loans with strong covenants have both "incurrence covenants," which require financial tests if the borrower wants to perform certain actions such as paying dividends, and "maintenance covenants," which require the borrower to regularly pass financial health tests such as maximum leverage levels and minimum interest coverage, or risk defaulting on the loan. Covenant-lite leveraged loans have incurrence covenants but lack maintenance covenants.

[13] Leverage is measured as the ratio of total debt to earnings before interest, tax, depreciation, and amortization (EBITDA). The average debt-to-EBITDA ratio for leveraged loan borrowers was 5.2 at year-end 2018, its highest level since at least 2002 and well above the 4.9 level that it reached in 2007.

future recoveries on defaulted leveraged loans are likely to be lower than previously experienced because of lower credit quality and weakened lender protections. Risks have been building in corporate debt securities as well. Most of the change in corporate debt outstanding over the past ten years was from lower-rated investment grade bonds and the highest-rated high-yield bonds, rather than from higher-rated investment grade bonds.[14]

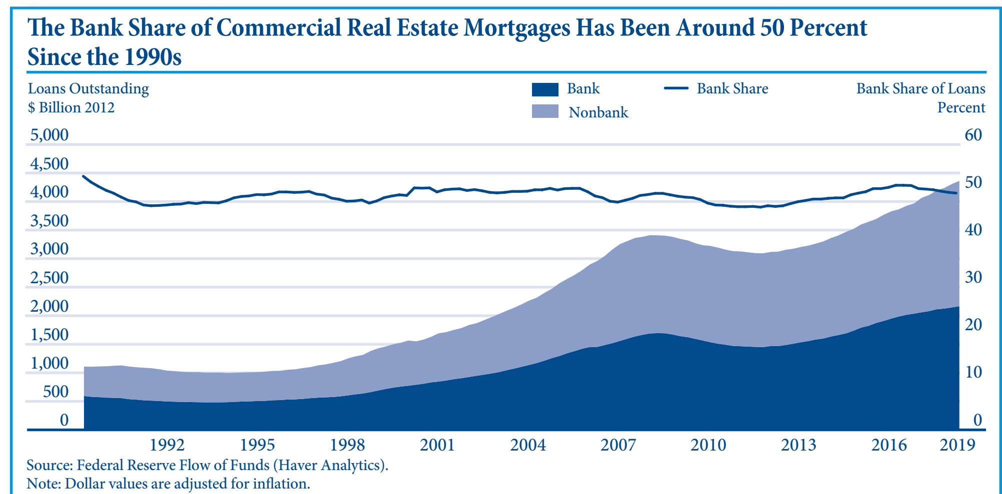
Banks' direct exposure to institutional leveraged loans has fallen during the past 20 years. But some banks still have direct exposure to revolving credit facilities that are often part of a leveraged loan deal and additional indirect exposure to institutional leveraged loans. This exposure includes (1) pro rata leveraged loans, (2) warehouse lines of credit used for collateralized loan obligations, and (3) subscription finance loans. Bank exposure to risk from nonbanks that participate in leveraged lending is opaque, and the nature and size of the risk is obscured. Risk is difficult to quantify because it is not reported in a standardized manner.

III. Other Lending Sectors

The migration of risks and activities between banks and nonbanks in lending sectors other than 1–4 family mortgages and leveraged lending has been less pronounced. This section summarizes market share developments in commercial real estate lending, agriculture lending, and consumer credit. Bank shares of outstanding loans in these sectors are significantly higher than in 1–4 family mortgage lending and in leveraged loans. Moreover, bank shares of outstanding commercial real estate loans and agriculture loans have increased, rather than decreased, since 2010.[15]

CRE Loans. CRE loans include loans secured by commercial or multifamily residential properties and unsecured loans to finance CRE activities. Banks have regained market share of CRE mortgages after a decline during the financial crisis (Chart 4). The bank share of commercial mortgages has been relatively steady at around 50 to 55 percent since the mid-1970s. In second quarter 2019, banks held 59 percent of commercial mortgages. In contrast, the bank share of multifamily residential mortgages decreased substantially between 1990 and 2012 and has modestly recovered since. Changes in bank share are largely attributable to GSE securitization activity. In second quarter 2019, GSEs held about half of the outstanding multifamily residential mortgages and banks held 33 percent.

Chart 4



The Bank Share of Commercial Real Estate Mortgages Has Been Around 50 Percent Since the 1990s

Source: Federal Reserve Flow of Funds (Haver Analytics).
Note: Dollar values are adjusted for inflation.

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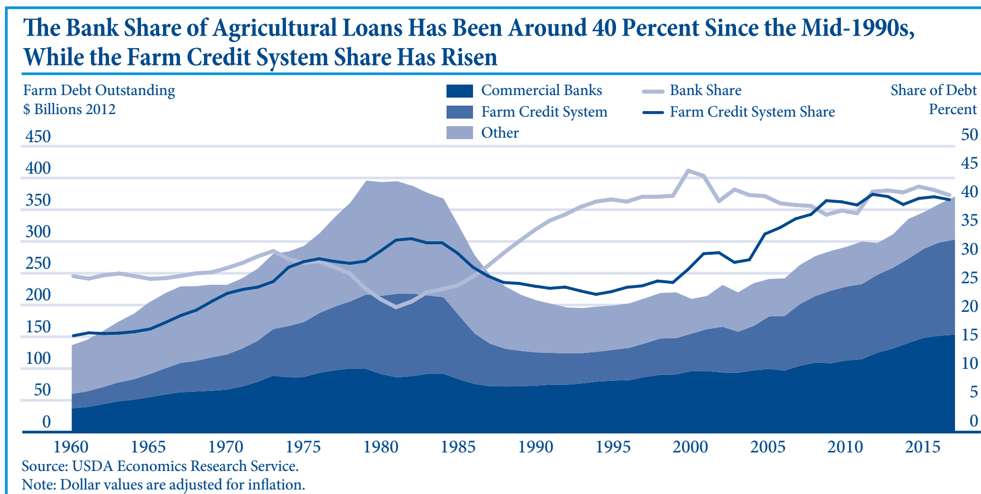
[14] ICE data services.

[15] For discussion of risks in these lending sectors see "FDIC 2019 Risk Review," https://www.fdic.gov/bank/analytical/risk-review/index.html.

Agriculture Lending. Quarterly Reports of Condition and Income (Call Reports) filed by FDIC-insured banks classify agricultural loans as (1) loans secured by agricultural land and (2) operating loans to farms and agricultural businesses. Agriculture loans are made primarily through banks and the Farm Credit System, a government-sponsored system of borrower-owned lenders that provide loans and related services to many rural customers. The bank share of agriculture lending is 42 percent and has varied between 37 and 45 percent since the early 1990s (Chart 5). The share of loans held by the Farm Credit System grew through the 1990s and early 2000s and is now around 41 percent of outstanding agriculture loans. In 2018, commercial banks and the Farm Credit System held 83 percent of farm sector loans, and the Farm Service Agency, Farmer Mac, life insurance companies, and individuals held the remainder of loans outstanding.[16]

Chart 5

The Bank Share of Agricultural Loans Has Been Around 40 Percent Since the Mid-1990s, While the Farm Credit System Share Has Risen



Source: USDA Economics Research Service.
Note: Dollar values are adjusted for inflation.

Consumer Credit. The bank share of consumer credit—loans to consumers that are not backed by real estate—fell from the late 1980s to the early 2000s because of securitization. Starting in the late 1980s, ABS backed by credit card debt, auto loans, and private student loans became widely used.[17] The bank share of consumer credit fell from 52 percent in fourth quarter 1990 to 35 percent in fourth quarter 2000. An accounting change in first quarter 2010, however, moved most ABS back onto the balance sheets of the firms that controlled the securities, causing a jump in the reported share of consumer credit held by banks from 35 percent in fourth quarter 2009 to 49 percent in first quarter 2010.[18] Because many of these loans are still securitized, some of the credit risk passes to the purchasers of the ABS even if the loans are on the bank's balance sheet. And in 2010, the federal government stopped subsidizing private lenders to make student loans and instead originates all federally subsidized loans itself.[19] This shift caused another decline in the bank share of consumer credit because only the federal government can make federally subsidized student loans (Chart 6). If student loans continue to grow faster than other forms of consumer credit, the bank share of consumer credit may continue to decline.

[16] USDA/ERS Farm Income and Wealth Statistics, https://data.ers.usda.gov/reports.aspx?ID=17835.

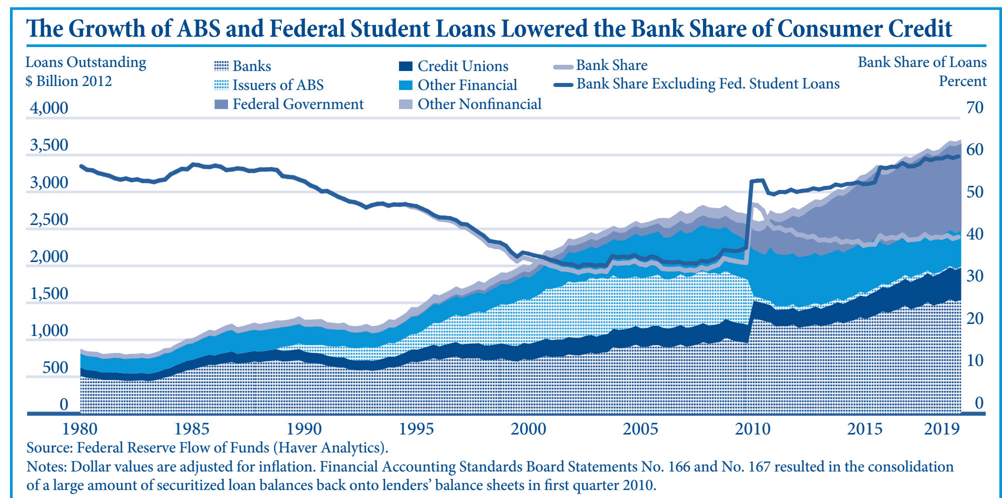
[17] Sumit Agarwal, Jacqueline Barett, Crystal Cun, and Mariacristina De Nardi, "The Asset-Backed Securities Market, the Crisis, and TALF," Federal Reserve Bank of Chicago *Economic Perspectives* 34, no. 4 (2010), www.chicagofed.org/publications/economic-perspectives/2010/4q-agarwal-barrett-cun-denardi.

[18] The accounting change was released in Financial Accounting Standards Board Statements 166 and 167. See https://www.fasb.org/jsp/FASB/FASBContent_C/NewsPage&cid=1176156240834 for a detailed explanation.

[19] H.R. 4872: "Health Care and Education Reconciliation Act of 2010," https://www.congress.gov/bill/111th-congress/house-bill/4872.

While the shift of consumer credit from banks to nonbank financial companies has been less pronounced than in other bank lending categories, consumer lending within the banking industry has become more concentrated. The top ten credit card lending banks held 34 percent of bank credit card loans in 1984 and 88 percent of bank credit card loans in second quarter 2019. The top two banks alone hold more than 30 percent of credit card loans.[20] In auto lending, the bank share of outstanding auto loans changed little from first quarter 2011 (35 percent) to first quarter 2018 (33 percent).[21] But the top ten large bank auto lenders hold 71 percent of outstanding bank auto loans, according to second quarter 2019 Call Reports.

Chart 6



Source: Federal Reserve Flow of Funds (Haver Analytics).
Notes: Dollar values are adjusted for inflation. Financial Accounting Standards Board Statements No. 166 and No. 167 resulted in the consolidation of a large amount of securitized loan balances back onto lenders' balance sheets in first quarter 2010.

IV. Lending to Nondepository Financial Institutions

Although direct bank exposure to some lending categories has fallen, banks may still have indirect exposure through lending to nonbank financial institutions (NBFI). Bank lending to NBFIs grew from about $50 billion in 2010 to $442 billion in second quarter 2019 (Chart 7). NBFI loans include loans to special purpose vehicles, private equity funds, real estate investment trusts (REIT), and nonbank mortgage lenders. About 11 percent of banks held NBFI loans in second quarter 2019, and the four largest banks—JPMorgan Chase N.A., Bank of America N.A., Citibank N.A., and Wells Fargo N.A.—held about half of the total of NBFI loans outstanding.[22] Bank supervisory experience suggests that outside of the large banks, most NBFI lending is to nonbank mortgage lenders or to MBS warehouse lines.[23] Through these loans, banks retain exposure to many of the loans that have shifted to nonbanks.

Other potential exposure includes loans to business development companies, other business lenders, private equity funds, venture capital funds, real estate funds, and REITs. These loans may be accounted for under different loan categories on a bank balance sheet, which can make it difficult to identify a bank's credit risk exposure to NBFIs.

[20] Credit card data are based on Call Reports. Citibank held 17 percent of bank credit card loans, and JPMorgan Chase N.A. held 16 percent of credit card loans.

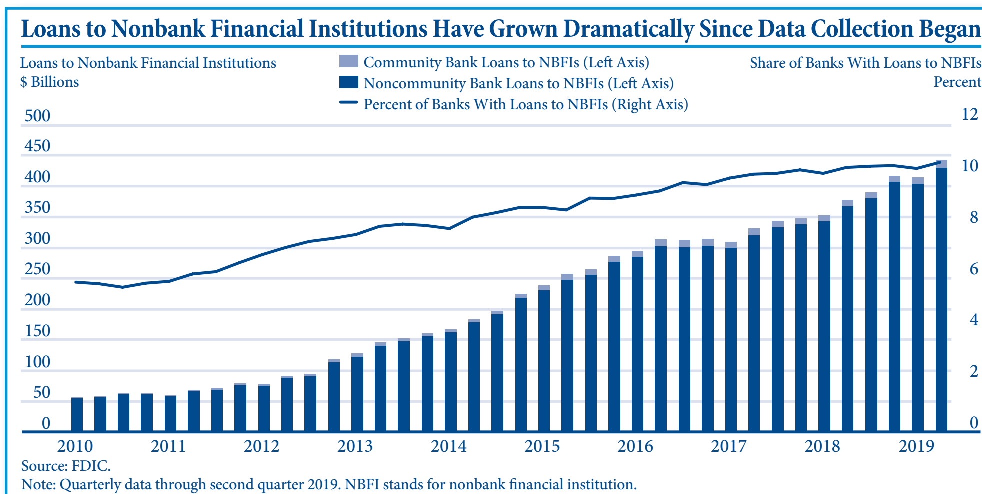
[21] Experian Automotive. In first quarter 2011, auto loans became a separate category on Call Reports. Before then, auto loans were included with other consumer loans and concentrations could not be identified.

[22] FDIC analysis of Call Reports.

[23] FDIC.

Banks may also hold securities that expose them to risks from nonbanks. For example, banks may hold collateralized loan obligations that include leveraged loans. Because Call Reports do not require detail about these asset classes, understanding the underlying credit risk of a bank's portfolios of securities and loans to nonbank financial institutions is difficult.

Chart 7



Source: FDIC.
Note: Quarterly data through second quarter 2019. NBFI stands for nonbank financial institution.

Conclusion

The banking industry and its activities have changed dramatically in 70 years. Securitization is a primary cause of the shift in loan origination from banks to nonbanks. If less-regulated financial institutions play a larger role in lending, the shift may alter underwriting standards when loan demand increases. For private securities such as PLMBS, this shift creates a market that is more liquid but could dry up quickly in a financial crisis, as we saw in the Great Recession. Studying where loans have shifted in lending sectors and the linkages among lenders deepens our understanding of risk in the financial system. The FDIC will publish a series of articles that look closely at the factors driving these trends and the related risks of residential mortgages and corporate debt and leveraged lending.

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