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Revolving Credit Lines to Oil Industry Pose New Hazards to Banks

As earnings season on Wall Street starts, investors in the big banks are just learning about unfunded revolving lines of credit (revolvers) that those banks extended to oil and energy related companies when times were better.

Ten of the largest U.S. banks, including JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo, just disclosed that they have $147 billion in unfunded revolvers, which are likely to expand their exposure to the energy industry just when they would rather reduce it.

Those banks have been setting aside loan loss reserves amounting to billions in anticipation of the inevitable: weak oil companies, with cash flow problems and an increasing risk of going bankrupt, grasping at the last available life preserver just to stay afloat. Fitch Ratings is expected to announce later this week that nearly two-thirds of energy loans that are either unrated or rated as junk will be classified as “in imminent danger of default.”

When defaults happen, they take investors’ and banks’ money with them. For example, Fort Worth-based Quicksilver Resources, which once boasted assets of $2.1 billion, was sold at auction in January for $245 million, a 90-percent haircut for lenders, and a total loss for investors. At the time the company’s CEO, Glenn Darden, sent a note of condolences: “This sale maximizes the value for the benefit of our creditors in the face of difficult market conditions.” What he didn’t say was that his company had just drawn down $209 million from its revolver prior to the sale.

Red flags are flying elsewhere: Midstates Petroleum just maxed out its $750 million line of credit with Sun Trust Bank by drawing out $249 million; Linn Energy did the same, taking out $919 million remaining in its $4 billion revolver with Wells Fargo; and SandRidge Energy maxed out its $1 billion line of credit by pulling $489 million from the Royal Bank of Canada.

Following the withdrawals, SandRidge missed a bond interest payment, which triggered a 30-day countdown to default, while Linn went immediately into bankruptcy.

The ripple effect of the decline in energy prices has touched Tidewater, Inc., a marine services company with 350 oil transport vessels. In March it announced that it withdrew the balance of its credit line, $600 million, from Bank of America. Tidewater’s CEO said his company pulled the cash due to “the uncertainty surrounding the future direction in oil and gas prices.”

Two questions investors are asking: How much do these phantom revolvers total, and how many of them are likely to disappear? Wells Fargo admitted that its present loans to the energy industry total $17.4 billion, but when revolvers are added in, the bank’s total exposure jumps to $42 billion. Citigroup has $58 billion exposed to the oil and gas industry; Bank of America, $43.8 billion; JPMorgan Chase,

$16 billion; Credit Suisse, $9 billion; and BNP Paribas, $38 billion. All told, more than a quarter of a trillion dollars is exposed to the industry as of the end of last year, according to federal bank regulators.

Christopher Helman did the math for *Forbes*, estimating that if the oil crunch continues to another year, “we could be looking at something in the neighborhood of $75 billion in oil and gas credit losses.” And that doesn’t include the evaporation of investors’ equity or the ripple effect of those losses across the entire energy industry.

Just when most banks want to decrease their exposure to that industry, they find their balance sheets being exposed to more of it.

Photo: AP Images

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