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CLIENT ALERT

Recent Remarks Indicate a Less Stringent Regulatory Approach to Leveraged Lending Guidelines

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In recent public remarks, key regulators denied the binding effect of the Interagency Guidance on Leveraged Lending (the "Guidance"), which was released to much fanfare in 2013 and imposed limitations on loans made by regulated institutions. While this should come as no shock to market participants, especially given recent actions by the U.S. Government Accountability Office (the "GAO"), the statements are the clearest indicator yet that regulatory efforts to police the leveraged lending market have begun to recede.

On February 27, 2018, Jerome Powell, Chairman of the Board of Governors of the Federal Reserve System (the "Fed"), told the U.S. House Financial Services Committee: "In the case of the leverage lending guidance, we do accept and understand that's nonbinding guidance. And in fact . . . we've made it a point to go out and make sure that that message is getting out to supervisors of banks."

On the same day, Joseph Otting, the head of the Office of the Comptroller of the Currency (the "OCC"), addressed the Guidance at an industry conference, where he said: "Institutions should have the right to do the leveraged lending they want, as long as they have the capital and personnel to manage that and it doesn't impact their safety and soundness. Meaning that if they did a ton of that and it was highly concentrated and started to deteriorate, then that is where we would be concerned from a safety and soundness basis." Thereafter, in an interview for an industry publication, he stated: "What we are telling banks is you have capital and expected loss models and so if you are reserving sufficient capital against expected losses, then you should be able to make that decision. The end result of that is I do think you will see leverage ratios float up over the next 12-18 months."[1]

The Guidance was jointly issued by the OCC, the Fed and the Federal Deposit Insurance Corporation on March 22, 2013, and set forth high-level principles related to prudent leveraged lending activities, including underwriting standards, valuation standards, the risk rating of leveraged loans and problem credit management.[2]

The Guidance was already under pressure by elected officials, including Senator Pat Toomey (R-PA), who asked the GAO to determine whether the Guidance is a "general statement of policy" and therefore a "rule" for purposes of the Congressional Review Act, meaning that the Guidance must be submitted to Congress for review before it can lawfully take effect. On October 19, 2017, the GAO answered that the Guidance is indeed a "rule." If Congress disapproves a "rule," it will thereafter be null and void and may not be reissued in a substantially similar form without subsequent statutory authorization.

Although the practical significance of the GAO finding has been uncertain, the statements by Messrs. Otting and Powell add to the likelihood that an official modification to, or formal repeal of, the Guidance may be forthcoming, and should give regulated lenders (as well as private equity sponsors, their portfolio companies and other borrower-side participants) additional comfort that the Guidance is no longer in force.

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1 See "OCC head says banks not bound by lending guidelines, expects leverage to increase," *Debtwire* (Feb. 27, 2018), available here.

2 For a detailed description of the Guidance, see our previous Client Alert entitled "Leveraged Lending Guidelines – 2013 to 2015 Impact" (Feb. 18, 2016), available here.

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