Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Interagency Statement on OCC and FDIC Withdrawal from the Interagency Leveraged Lending Guidance Issuances

The Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation (collectively "the agencies") are rescinding the "Interagency Guidance on Leveraged Lending" ("2013 Guidance"), dated March 21, 2013, and the "Frequently Asked Questions for Implementing March 2013 Interagency Guidance on Leveraged Lending" ("2014 FAQs"), dated November 7, 2014. The agencies expect banks to manage leveraged lending exposures consistently with general principles for safe and sound lending.

Background

Leveraged lending plays a vital role in the U.S. financial system. It provides a wide range of businesses, including those that are highly indebted or highly leveraged or that have low obligor ratings, with access to capital for business transformations, including mergers, acquisitions, re-capitalizations, refinancings, and equity buyouts, as well as for business and product line buildouts and expansions. It enables businesses to grow in a manner and at a rate that may not otherwise be possible. This growth helps fuel the nation's economy, contributing to innovation and job creation.

Banks traditionally participate in the leveraged lending market by providing or arranging financing and by facilitating the syndication process. Banks also have indirect exposure to leveraged borrowers via lending to business development companies and certain debt funds, as well as investments in collateralized loan obligations that contain securitized leveraged loans.

The 2013 Guidance and 2014 FAQs were overly restrictive and impeded banks' application to leveraged lending of the risk management principles that guide their other business decisions. This resulted in a significant drop in leveraged lending market share by regulated banks and significant growth in leveraged lending market share by nonbanks, pushing this type of lending outside of the regulatory perimeter. In addition, the guidance was overly broad and captured certain types of loans that were not intended to be covered, including loans to investment-grade companies.

Moreover, the U.S. Government Accountability Office found that the 2013 Guidance was a rule for the purposes of the Congressional Review Act[1] that was required to be submitted to Congress for review. However, the agencies never submitted the 2013 Guidance to Congress.

For these reasons, the agencies are rescinding the 2013 Guidance and the 2014 FAQs. In place of these issuances, banks should apply the agencies' general principles for prudent risk management of commercial loans and other types of lending to their leveraged lending activities. In general, banks should consider the following general principles for safe and sound lending when managing the risks associated with leveraged lending:

1. Banks involved in leveraged lending are exposed to core financial risks—primarily credit and liquidity risks—which may be more pronounced given the activity and profile of the borrowers. The key to safe and sound banking is effectively managing these risks. A bank should manage the risks associated with its leveraged lending activities and tailor its risk management practices based on the quantity of the risk inherent in such activities.

2. A bank should have a clearly defined risk appetite that is reasonable and reflects the aggregate level and types of risk it is willing and able to assume to achieve its strategic objectives. A bank's leveraged lending activities should clearly align with this risk appetite.

3. Each bank should have effective risk management and controls for transactions in its pipeline, including loans to be held and those to be distributed.

4. Each bank should determine its own definition of a "leveraged loan." A bank's application of a bank-wide, consistent definition supports its ability to identify, measure, monitor, and control its aggregate exposure to leveraged lending and to determine adherence to its risk appetite and concentration limits, including for indirect exposures.

5. A bank's underwriting criteria should consider a loan's purpose and sources of repayment and the capacity to de-lever over a reasonable period. Given the risk profiles of leveraged lending transactions, underwriting criteria should be consistently applied to these transactions.

[1] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation--Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending | U.S. GAO

6. Because leveraged borrowers start with high debt relative to cash flow, a bank should conduct an analysis of a leveraged borrower's past and current performance compared with projections, as well as the assumptions on which the projections are based.

7. Because leveraged borrowers generally depend on access to the capital markets or banks for refinancing, a bank should monitor a leveraged loan throughout its life cycle to assess the risk that refinancing is unavailable and to appropriately manage changes to the loan's risk profile.

8. A bank that purchases a participation in a leveraged loan should make a thorough independent evaluation of the transaction and risk involved before committing funds. The same credit assessment and underwriting criteria should be applied as if the bank were originating the loan internally.

Examiners will examine banks' underwriting, review risk ratings, and monitor the adequacy of loan loss reserves in accordance with general principles of safe and sound lending in a manner tailored to the size, complexity, and risk of leveraged lending activities.

The agencies will consider issuing additional guidance related to leveraged lending as appropriate. The agencies commit to issuing any further guidance through the notice and comment process.