Credit Policy: Request for Comment on Revised Leveraged Lending Guidance

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the agencies) are seeking comment on proposed revisions to the interagency leveraged finance guidance issued in April 2001 (2001 guidance). This notice and request for comment was published in the Federal Register on March 30, 2012 (attached).

Since issuance of the 2001 guidance, the agencies have observed tremendous growth in the volume of leveraged credit and in the participation of non-regulated investors. The pipeline of aggressively structured commitments has grown rapidly, management information systems (MIS) have at times proven less than satisfactory, and many institutions have found themselves holding large pipelines of higher-risk commitments at a time when buyer demand has diminished significantly.

In light of the market’s evolution, the agencies propose replacing the 2001 guidance with revised leveraged finance guidance that refocuses attention to five key areas:

- Determining an Institution’s Risk Appetite: This requires the explicit involvement of management and the board in setting an institution’s portfolio and pipeline risk limits.
- Underwriting Standards: These outline the agencies’ expectations for cash flow capacity, amortization, covenant protection, and collateral controls and emphasize that the business premise for each transaction should be sound and its capital structure should be sustainable, irrespective of whether underwritten to hold or distribute.
- Valuation Standards: These concentrate on the importance of sound methodologies in the determination and periodic revalidation of Enterprise Value.
- Pipeline Management: This highlights the need to accurately measure exposure on a timely basis, the importance of having policies and procedures that address failed transactions and general market disruption, and the need to periodically stress test the pipeline.
- Reporting and Analytics: This emphasizes the need for MIS that accurately captures key obligor characteristics and aggregates them across business lines and legal entities on a timely basis. Reporting and analytics also reinforces the need for periodic portfolio stress testing.

Comment is requested on the burden of implementing certain aspects of the proposed guidance, and comments will be accepted through June 8, 2012. Any questions regarding...
this proposed guidance should be directed to Credit Risk Policy Division at (202) 649-6670.

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Related Link

- Proposed Revised Guidance (PDF)