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BY ELECTRONIC SUBMISSION

Robert Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

RE: Proposed Guidance on Leveraged Lending

Ladies and Gentlemen,

CapitalSource Bank appreciates the opportunity to provide comments to the Federal Deposit Insurance Corporation concerning the Proposed Guidance on Leveraged Lending ("Proposed Guidance") published in the Federal Register on March 30, 2012 by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency ("Agencies").

CapitalSource Bank agrees with the Agencies' acknowledgement in the Proposed Guidance that "leveraged finance is an important type of financing for the economy." Banks play a critical role in making credit, including leveraged loans, available to borrowers to support the growth of businesses and jobs. Not only do leveraged loans provide these generally good quality borrowers with the capital they might not otherwise be able to access, through syndication they allow many banks to diversify their asset classes to include credit worthy borrowers outside their local markets.

CapitalSource Bank also agrees with the importance of ensuring that financial institutions provide leveraged financing in a safe and sound manner. We believe that reviewing the leveraged finance guidance issued in 2001 to incorporate experience over the interim, especially during the recent financial crisis, is a sensible and constructive effort. However, we are concerned that certain aspects and interpretations of the Proposed Guidance would create potential burdens and unintended consequencess, especially for smaller institutions. We feel the intent of the Proposed Guidance should be to focus on large leveraged loans used to finance buyouts, acquistions, and capital distributions which rely on enterprise value and other intangibles. The Proposed Guidance should outline high-level principles, not specific or suggested details, and allow banks to develop their own detailed risk management framework for leveraged loans which is most appropriate to each individual bank. Therefore, we offer the following comments for your consideration.

The applicability of the Proposed Guidance to community and smaller banks is underestimated.

Although the Applicability section in the Proposed Guidance states "the vast majority of community banks should not be affected by this guidance as they have no exposure to leveraged credits", it is likely that many community and smaller institutions do in fact participate in leveraged lending through broadly syndicated transactions which appear to be the focus of the Proposed Guidance. If the administrative burden becomes too great, smaller institutions might withdraw from syndicated markets, potentially impacting liquidity for those transactions. In addition, without exclusions for certain size institutions, product types, and loan sizes (see below and comment on exclusions), transactions which do not appear to be the intended focus of this Proposed Guidance would fall under it, significantly increasing the risk management administrative burden, which again has a greater impact on smaller institutions. Consistent with other guidance which delineates small and large banks, we would suggest specifically excluding institutions with under $10 billion in assets from this Proposed Guidance, unless an institution's Federal regulator determines through examination that the risk from the concentration, quality, or management of leveraged lending warrants its application.

Banks should retain discretion in developing detailed sound risk management for leveraged lending activities, and suggested or example numeric measures should not be part of guidance.

Unlike the 2001 Guidance on Leveraged Financing, the Proposed Guidance includes numerous suggested levels rather than only providing guidance on concepts and leaving the establishment of the levels and details of sound risk management which are most appropriate to each specific institution up to that institution. Several examples are including references to leverage of 4.0x and 3.0x EBITDA in the Definition of Leveraged Finance section as opposed to just saying leverage as appropriate multiples of EBITDA, and the ability to fully amortize senior debt over a five to seven year period in the Underwriting Standards section as opposed to just saying capacity to repay and delever over a reasonable period. Providing conceptual guidance or high-level principles without any numeric references would be more beneficial for several reasons. In today's complex financial world, with various industries, niches, and other specialties, one size does not fit all and does not allow an institution to capitalize on the expertise it might have. Second, even if stated as a general guide or example, the inclusion of numbers in guidance may imply those numbers are the only acceptable standards and inhibit any deviation from those numbers in policy, lending practice, or interpretation by regulators, even if well justified by the risk profile of an industry or sector.

Leveraged loans should be determined at origination or renewal, and "fallen angels" should not be considered leveraged lending.

Footnote 8 in the Definition of Leveraged Finance in the Proposed Guidance indicates that loans which did not initially meet the institution's definition of leveraged lending, but later meet it due to financial performance and prospects deteriorating should be added to the leveraged portfolio. Leveraged loans should be determined based on the loan purpose and resulting leverage or other industry appropriate measure at the time the transaction is originated or refinanced. If a loan backs into the leveraged definition, it would be a matter of risk migration which should be addressed under the institution's normal problem loan risk management process. Assuming safe and sound practices, an institution will already have appropriate problem loan risk management in place, and creating an additional layer for leveraged lending increases the administrative burden without necessarily improving the effectiveness of credit management and outcome. In addition, including "fallen angels" in leveraged lending portfolio statistics would skew the true measure of leveraged loans originated by the institution.

The valuation methodology and standards outlined in the Proposed Guidance are onerous.

The Valuation Standards in the Proposed Guidance note that "enterprise valuations should be performed or validated by qualified persons independent of the origination function" and that "valuation estimates should reconcile results from the use of all three [valuation] approaches". The independence requirement could be difficult for smaller institutions given less specialization in staffing, and often the originators have the best access to the key information and the industry expertise to most effectively calculate enterprise valuations. In many cases, not all of the valuations approaches will be applicable and often accurate information to complete all three is not available. Banks typically use other methods such as EBITDA or revenue multiples to calculate enterprise values, and these methods have proven credible over time. Therefore, requiring banks to complete the three stated valuation methods would be inefficient and would not improve the quality of the underwriting.

The MIS needed for Reporting and Analytics detailed in the Proposed Guidance may prove burdensome and duplicative.

CapitalSource Bank agrees that MIS must be adequate to identify, aggregate, and monitor true leveraged loan exposures. However, the Proposed Guidance would broadly expand the definition, and therefore number, of leveraged loans and would increase the complexity of MIS required to meet the reporting and analytics in the Proposed Guidance, especially for smaller institutions without extensive systems, separate departments, and programming resources. Without the exclusions noted in other comments herein, the effectiveness of reporting on leveraged lending would be diluted and less effective to the risk management process.

The need to thoroughly underwrite and monitor deal sponsors should be qualified to only include transactions where the deal sponsor provides financial guarantees.

CapitalSource Bank agrees that the need to understand the qualifications and past experience of a deal sponsor are important considerations in the underwriting of a leveraged transaction. However, the sponsor evaluation standards in the Proposed Guidance are administratively burdensome or impossible to meet and do not add value unless the deal sponsor is providing financial guarantees of the leveraged transaction. In addition, banks participating in broadly syndicated transactions would have no access to the sponsor to obtain such information.

There should be exclusions based on loan purpose, type, and size for applicability of the Proposed Guidance.

As currently drafted, the Proposed Guidance could encompass asset based loans, real estate loans, small business loans, guaranteed loans, and other types of loans. CapitalSource Bank believes the true intent is to capture larger leveraged loans with two common characteristics: proceeds were used for buyouts, acquisitions, or capital distributions, and reliance on enterprise value rather than tangible collateral. All properly structured and monitored asset based loans should be excluded in the Proposed Guidance. Asset based loans, whether secured by accounts receivable, inventory, equipment, real estate, or other tangible assets, each appropriately margined, may have a higher risk of default if leveraged, but the loss severity should not be materially different than for an unleveraged asset based transaction. Unless there is a loan size exclusion (i.e. – loans must be in excess of $5 or $10 million), many small business loans used for business transition would fall under the Proposed Guidance. In addition, loans guaranteed by a government program such as the Small Business Administration should be excluded, because while there might be overall risk from leverage, the institution has mitigated that risk by obtaining a guarantee.

Thank you for your consideration of our comments on the Proposed Guidance designed to update and promote safe and sound banking practices with regard to leveraged lending. If you have any questions, please contact me at jpeterson@capitalsource.com or 301-841-2796.

Sincerely,

James H. Peterson
Senior Vice President
Director of Credit & Credit Policy