MEMORANDUM

TO: Public File – Proposed Guidance on Leveraged Lending

FROM: Gregory S. Feder, Counsel, FDIC Legal Division

DATE: October 1, 2012

SUBJECT: Meeting with Triune Global Financial Services

On September 17, 2012, representatives from the FDIC's Division of Risk Management Supervision (Bill Baxter, Senior Examination Specialist), and Legal Division (Greg Feder, Counsel) met with Tim Alexander, Managing Director of Triune Global Financial Services. Also present were staff members from the Board of Governors of the Federal Reserve System (Carmen Holly) and the Office of the Comptroller of the Currency (Lou Ann Francis and Kevin Korzeniewski).

The agenda for the meeting involved certain provisions of the interagency proposed guidance on leveraged lending. The proposed guidance was published in the Federal Register of March 30, 2012 (77 FR 19417). The primary topics for this meeting, as requested by Mr. Alexander, were: the definition of "leveraged lending," the characteristics of "covenant lite" loans, and valuation of the borrowing base.

Attached is a copy of the materials provided to the FDIC.

Triune

Presentation o Commercial Lending as presented to the

Federal Reserve
Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation

Timothy Alexander
Managing Director
September 2012

1. BACKGROUND

Of late, there has been increasing interest and perhaps, concern from Regulators concerning commercial or C&I Lending. The culmination of the concern could be said to be several proposed rules aimed at C&I lending. These proposed rules may seem to provide addition tools for Regulators in the supervision of banks and C&I lending.

The presenter believes these proposed rules may have considerable unintended consequences.

2. PRESENTATION GOALS

If it is possible the proposals may have unintended consequences, it may be possible to develop other tools, alternatives to existing proposals.

The goal is to provide alternative tools for Regulators. In order for tools to be considered, they should be understandable, based on established techniques, ready for immediate use

3. PRESENTER

The presenter is Tim Alexander and the company is Triune. For more than 20 years Mr. Alexander has been providing due diligence services to banks across the nation. Services include appraisals, collateral audits, liquidations, etc. The work is in support of commercial loans, large and small.

Recently Triune has been much more active in regulatory matters. One may imagine an occasional divergence between the letter of a regulation and the practice of the same. As we participate in new regulatory issues and the execution of banking "on the ground", we have found many interested in our observations of banking. Mr. Alexander has been invited numerous times to D.C. for the purpose of sharing our observations with Regulators.

T

4. LEVERAGED LENDING

In recent proposals, there is an interest in defining a "Highly Leveraged Loan". One possible definition is that of leverage; beyond a point, say seven times, a loan is defined as "Highly Leveraged". With the definition, additional steps may be within Regulatory purview.

It is reasonable to think that setting a single metric may not be burdensome. However, the contrary may prove true.

a. Deployment-is the metric an average applied to a holing company, applied to business units, average per portfolio, or per loan?

   Much economic analysis is currently performed on such as Call Reports. These reports are so highly summarized and averaged as to approach meaninglessness. What about on a top entity or holding company basis.

   In the modern, complex institution, there may be several distinct entities, all selling commercial loans. These loans can be so diverse and separate that attempting to provide a consolidated view of a pipeline or even a single metric would be of no value.

   Consider the following simple example. This is a bank with three distinct C&I lending segments. Let there be a desire to report an overall metric of leverage and set an entity-wide cap at six times.

Big Bank Sample 1

	Corporate Bank		**Business Credit**		**Factor**	
	Loans	leverage	Loans	leverage	Loans	leverage
	$100	3.50	$100	6.00	$100	7.25
	$100	4.00	$100	6.50	$100	7.75
	$100	4.50	$100	6.75	$100	8.25
Total	$300		$300		$300	
Average Leverage		4.00		6.42		7.75
Corporate Average				6.06		

Big Bank Sample 2

	Corporate Bank		**Business Credit**		**Factor**	
	Loans	leverage	Loans	leverage	Loans	leverage
	$100	3.50	$100	6.00	$100	7.25
	$100	4.00	$100	6.50	$100	7.75
			$100	6.75	$100	8.25
					$100	4.50
Total	$200		$300		$400	
Average Leverage		3.75		6.42		6.94
Corporate Average				5.70		

7

In the first example, the overall average leverage is just above the threshold, and in the second the leverage is just below after moving loans between portfolios.

There is no implication this is occurring. This is just a very simple to illustrate the possibility of skewing metrics at the many levels.

The next problem is that most major banks have multiple lending units, each with a individual risk profile and foot print.

Bank 1

Corporate Bank | Business Credit | Specialty Finance

The above is an example. Suppose the corporate bank will tolerate up to three or four times leverage, the business credit may go to ten or so, and specialty finance higher still. Which unit does the standard apply too? If the proposal is seven times, the average corporate bank unity could see a 50% increase in risk, the business credit will be limited and the specialty finance out of business.

While most banks will have the same units, they may vary slightly in construction. See the following.

Bank 1

Corporate Bank | Business Credit | Specialty Finance

Bank 2

Corporate Bank | Business Credit | Specialty Finance

Bank 3

Corporate Bank | Business Credit | Specialty Finance

b. Conclusion-Existing proposals.

Using a single, arbitrary metric may sound simple and feasible, but very difficult to implement. If the standard is imposed at a loan basis, there is an inherent conflict between tolerable leverage at the various lending segments or units.

c. Alternatives

Tool number one. Rather than a hard metric defining "Highly Leveraged Loans", try a soft number. Use the existing line of demarcation between the Corporate Bank and other units. The line of demarcation will vary slightly between Banks and over time. This is important to allow for competition and market changes. But, the outer limit will never approach the discussed limit.

5. Covenant Light

There seems to have been an ongoing concern by Regulators about some loans being viewed as covenant light. Covenant light is a difficult term to define, much like "warm". Rather than discussions here on this term, we will offer specific tools to measure covenants and then to manage exceptions.

a. Measuring covenants. In everyday use, the number 10 is significant. Accounts will use 10% as a test for materiality. Why not use the number 10 to measure covenants as tight or loose. If a covenant allows a number to drift more than 10% without being triggered, it can be declared loose. Try this test.

b. Exceptions are a grey area. What to do if a covenant is triggered? Is it material or not?

Our suggestion for a third tool is this. If there is a material covenant breach, immediate and corrective action must be taken. A reasonable definition of a material breech is as follows.

i. If a financial covenant is violated with more than a 10% variance, immediate and corrective action to be taken.
ii. If there are three or more immaterial violations.

The next question is what to do after a violation. If the idea of 10% has merit, then part of the correction could be a new set of covenants allowing for a reduced variance of not 10%, but 7.5%, or 5%. The loan could be transferred to a formula, or moved to another unit for monitoring.

7

6. Other

There are additional programs in place that, if more widely deployed, would change the face of supervision. For example, one of the Regulators is asking for vary detailed information from banks. This would include electronic, line item detailed data per loan.

This alone would take supervision and economic analysis from the Flintstones to the Jetsons, which is needed.

7. Conclusion

The reason for current proposals is understood. However, the pronouncement of a single, arbitrary metric, such as leverage, may not go over well. Rather, using the existing lines of business within banks, there is less resistance and a tighter metric.

As far as covenants being few or excessive, the only true test would be a survey of the detailed information as mentioned in point six, over time. But what can be done now is to tighten covenants against a solid, acceptable standard, then react to material deviations.

We see loans being mislabeled and this is a problem. Regulators can either ask for a sample and hope exceptions are found or request the entire loan detail, and then review the data looking for exception.

Due diligence is a topic that to some extent has been downgraded. The various forms do not mesh well. The due diligence should be a primary offset to loans but is sometimes not viewed as such.

7