

MEMORANDUM

TO: Public File – Interagency Guidance on Leveraged Lending

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

DATE: May 29, 2013

SUBJECT: Meeting with LSTA and ABA representatives

On May 9, 2013, representatives from the FDIC's Division of Risk Management Supervision (Thomas Lyons, Senior Examination Specialist, and Mark Sheely, Senior Large Financial Institutions Specialist) and Legal Division (Greg Feder, Counsel) met with representatives from the Loan Syndications and Trading Association (R. Bram Smith, Executive Director; Meredith Coffey, Executive VP; and Elliot Ganz, Executive Vice President) and American Bankers Association (Robert Strand, PhD, Senior Economist, and Denyette DePierro, Senior Counsel). Also present were staff members from the Board of Governors of the Federal Reserve System (Rob Cote, Carmen Holly, and Ben McDonough) and the Office of the Comptroller of the Currency (Lou Ann Francis, Kevin Korzeniewski, Chris Torraca, and Grant Wilson).

The agenda for the meeting involved the meaning of the agencies' expectations regarding the May 21, 2013 "compliance date" specified in the final Interagency Guidance on Leveraged Lending, published in the Federal Register on March 22, 2013 (78 FR 17766).

Staff from the agencies explained that the "compliance date" is not a date by which staff expects institutions to have fully implemented the expectations in the guidance. Rather, consistent with the Paperwork Reduction Act, May 21 is the date that examiners reviewing institutions' policies and procedures would first expect institutions to be able to explain clearly what they are doing to address issues raised by the guidance, and for the institutions to demonstrate that they are making significant and meaningful progress toward implementing the guidance. What constitutes "significant and meaningful progress" would vary depending on the timing of the examiner review and the level [and materiality] of the institution's leveraged lending activity.

Attached is a copy of the LSTA and ABA letter sent to the agencies on April 11, 2013.



American
Bankers
Association

April 11, 2013

BY ELECTRONIC SUBMISSION

Office of the Comptroller of the Currency
Legislative and Regulatory Activities
Division
Attention: 1557-NEW
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219

Gary Kuiper, Counsel
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Room NYA-5046
Washington, DC 20429

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Interagency Guidance on Leveraged Lending

Ladies and Gentlemen,

The Loan Syndications and Trading Association (“**LSTA**”)¹ and the American Bankers Association (“**ABA**”)² write to the Office of the Comptroller of the Currency (the “**OCC**”), the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the “**FDIC**”) (collectively, the “**Agencies**”) concerning the Interagency

¹ The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trading of commercial loans. The 321 members of the LSTA include commercial banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers, and other institutional lenders, as well as service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty.

² The ABA represents banks of all sizes and charters and is the voice for the nation’s \$14 trillion banking industry and its 2 million employees. Additional information about the ABA is available at the ABA’s website, www.aba.com.

Guidance on Leveraged Lending (the “**Guidance**”).³ The Proposed Interagency Guidance on Leveraged Lending (the “**Proposed Guidance**”) was released for public comment on March 30, 2012.⁴ The LSTA and the ABA jointly submitted comment letters to the Agencies dated June 8, 2012 and August 21, 2012. The Agencies issued the Guidance on March 22, 2013, effective on that date, with a “compliance date” of May 21, 2013.

On behalf of our members, we respectfully request the Agencies revise the Guidance to remove the reference to a May 21, 2013 compliance date and to explicitly provide institutions with up to twelve (12) months to implement the Agencies’ suggestions. As further discussed below, the Guidance requires the potential implementation of significant changes to our member institutions’ policies and procedures, as well as their management information systems that are not possible within the two-month period provided for in the Guidance. In addition, aspects of the final Guidance raise important interpretive questions that will need to be addressed in order for institutions to make the changes necessary to achieve proper implementation.

While our member institutions have begun considering implementation of the Guidance, full implementation will require substantial additional work. Our members must revise their risk management framework and policies and procedures, including their underwriting, stress testing, and reporting policies and procedures. Such changes will require thoughtful consideration and approval by both senior management and the board of directors. Once the policies and procedures are approved, management information system coding must be developed and implemented, outstanding loans must be re-coded, and testing must be performed to correct for errors.

Our members expect the changes to their systems to be a time consuming process. Each of the Agencies’ modest time estimates for these modifications is far less than the approximately 10,000 hours that several of our members have estimated, based on other similar and recent system modifications. The OCC’s own estimate of 1,350 hours per institution to build the system would entail an institution employing at least four people, full-time, for more than eight weeks. In light of the industry and regulatory estimates, as well as some of the implementation challenges discussed below, the current eight-week compliance period is not sufficient.

We would like to draw the Agencies’ attention to a few examples of the implementation challenges our institutions face under the Guidance. Each of these examples, and others not addressed here, were not part of the 2001 interagency guidance and require considerable changes in the manner in which our institutions track and report leveraged lending.

- The Proposed Guidance required that “fallen angels” be included in an institution’s definition of leveraged lending. The Guidance still requires the inclusion of fallen angels

³ Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17,766 (Mar. 22, 2013).

⁴ Proposed Guidance on Leveraged Lending, 77 Fed. Reg. 19,417 (Mar. 30, 2012).

in the event the credit is “modified, extended, or refinanced.” This change will require our members to develop new policies and systems to identify and track “fallen angels” as they move in and out of the definition of leveraged lending. The addition of “modified” credits is particularly problematic as generally, our member institutions’ current procedures do not contemplate such a reassessment of loans when they are modified.

- Like the Proposed Guidance, the Guidance appears to require institutions to include coverage of leveraged loans held in a bank’s trading portfolio and asset based loans that are part of the entire debt structure of a leveraged obligor. As noted in our prior letters, because of the different risks associated with them, these loans are managed and monitored differently. The inclusion of both would require significant modifications to an institution’s management information systems.
- Unlike existing regulations, the Guidance includes indirect exposure via limited recourse financings secured by leveraged loans or financing extended to financial intermediaries (such as conduits and special purpose entities that hold leveraged loans). These exposures reside in various business lines across the member institutions. The inclusion of such exposures under the Guidance will require our member institutions to revise various policies, procedures and systems to begin to capture these exposures, without clarity regarding the weighting that should be applied to them.

By way of contrast to the current proposed time table, the FDIC’s October 2012 Final Rule on Assessments, Large Banking Pricing (the “**FDIC Rule**”), which defined higher risk C&I loans, was not effective until April 1, 2013.⁵ We believe that the challenges posed by the Guidance are far greater than those posed by the FDIC Rule. The Guidance goes beyond reporting to include modifications to policies, procedures, reporting, monitoring and related changes in management information systems. The FDIC Rule also did not mandate a reexamination of the entire C&I loan portfolio. Given these disparities, providing less time under the Guidance is incongruous.

We also note that the Guidance specifically states that “this final guidance is not being adopted as a rule”⁶ Courts have been clear that agencies may issue guidance to alert the industry on how they will address institutions on a case-by-case basis, provided that the guidance is not binding and does not change existing standards or requirements.⁷ In this case, however, the Guidance materially changes the definition of leveraged lending. Moreover, the Guidance references a “compliance date” of May 21, 2013, thereby conveying the Agencies’ position that compliance with the Guidance is mandatory. Requiring compliance and changing

⁵ FDIC Assessments, Large Bank Pricing, 77 Fed. Reg. 66,000 (Oct. 31, 2012) (codified at 12 C.F.R. Part 327).

⁶ 78 Fed. Reg. 17,766, 17,769 (Mar. 22, 2013).

⁷ *Syncor Int’l Corp. v. Shalala*, 127 F.3d 90, 94 (D.C. Cir. 1997) (stating that guidance, as opposed to a rule, does not “impose or elaborate or interpret a legal norm”).

the leveraged lending standards for lenders, the Guidance creates confusion as to whether the Guidance is essentially a binding rule, notwithstanding the Agencies' statements to the contrary.⁸

In summary, the LSTA and the ABA respectfully request that the Agencies revise the Guidance to delete the sentence that states: "The compliance date for this guidance is May 21, 2013." In addition, we request that the revised Guidance explicitly acknowledge that the changes that the Guidance recommends in underwriting policies and procedures, reporting, monitoring, and management information systems be implemented as promptly as possible, no later than 12 months following the adoption of the Guidance, in order to provide institutions sufficient time to overhaul their businesses to meet the expectations of the Guidance.

We are grateful for the Agencies' efforts and willingness to work with the LSTA and ABA over the last year, and we sincerely appreciate your consideration of our request. If you have any questions, please do not hesitate to contact: Elliot Ganz, General Counsel, LSTA (eganz@lsta.org; (212) 880-3003); Meredith Coffey, Executive Vice President for Research and Analysis, LSTA (mcoffey@lsta.org; (212) 880-3019); Denyette DePierro, Senior Counsel, Office of Regulatory Policy, ABA (ddepierr@aba.com; (202) 663 5333); or Robert Strand, Senior Economist, Office of the Chief Economist, ABA (rstrand@aba.com; (202) 663-5350).

Sincerely,

THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION



R. Bram Smith
Executive Director
366 Madison Avenue, 15th Floor
New York, NY 10017
bsmith@lsta.org

AMERICAN BANKERS ASSOCIATION



Cecelia Calaby
Senior Vice President
Office of Regulatory Policy
1120 Connecticut Avenue, NW
Washington, DC 20036
ccalaby@aba.com

⁸ See *Appalachian Power Co. v. EPA*, 208 F.3d 1015 (D.C. Cir. 2000) (holding that a document labeled as "guidance" by an agency is instead a legislative rule where it has a "binding effect").