From: Felfe, Tess
To: Regs.Comments
Cc: ddepierr@aba.com; rstrand@aba.com; Ganz, Elliot; Coffey, Meredith; Smith, Bram
Subject: Docket Number OCC-2011-0028
Date: Friday, June 08, 2012 5:50:00 PM
Attachments: Final Leveraged Lending Guidance Comment Letter (6-8-12).pdf

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Dear Sir/Madam:

In response to the Agencies' request for comments on the Proposed Leveraged Lending Guidance, please find the Loan Syndications and Trading Association (LSTA) and the American Bankers Association (ABA)'s joint comment letter. Please do not hesitate to contact us with any questions or if we can be of any assistance.

Kind regards,

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June 8, 2012

BY ELECTRONIC SUBMISSION

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
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Robert Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
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: Proposed Guidance on Leveraged Lending
(Docket Nos. OCC-2011-0028 & OP-1439)

Ladies and Gentlemen,

The Loan Syndications and Trading Association ("***LSTA***")[1] and the American Bankers Association ("***ABA***")[2] appreciate the opportunity to provide comments to the Office of the Comptroller of the Currency ("***OCC***"), the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the "***Agencies***") concerning the Proposed Guidance on Leveraged Lending ("***Proposed Guidance***"). The Agencies published the

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.

Proposed Guidance in the *Federal Register* on March 30, 2012 and sought comments by June 8, 2012.[3]

The LSTA and ABA agree with the Agencies' acknowledgement in the Proposed Guidance that "[l]everaged finance is an important type of financing for the economy."[4] The banking industry plays a critical role in making credit, including leveraged loans, available to borrowers to support the growth of businesses and jobs and, through the origination and distribution of loans, also provides opportunities for institutional lenders to participate in the recovery of the economy. According to the Shared National Credit ("***SNC***") Review, in 2011, syndicated loans in the United States provided $2.5 trillion in financing to U.S. companies.[5] Based on data compiled by the LSTA and the data in the SNC Review, we estimate that approximately $1 trillion of these syndicated loans are to borrowers that are below investment grade. More than half of the below investment grade loans are held by non-bank institutional lenders. Leveraged loans provide these generally good quality borrowers with the capital they might not otherwise be able to access.

We also agree on the importance of ensuring that financial institutions provide leveraged financing in a safe and sound manner. Revisiting the leveraged finance guidance issued over a decade ago in light of experience during the interim is a sensible and constructive effort. However, we respectfully submit that the Proposed Guidance appears to expand the scope and substance of the current guidance beyond improvements to current practices to alter key aspects of the management of leveraged finance.

We are concerned that the Proposed Guidance could curtail banks' participation in certain prudent leveraged finance transactions and, therefore, negatively impact the availability of credit in the marketplace. To the extent that the Proposed Guidance would decrease leveraged lending, it would adversely affect what is widely seen as a dynamic and important activity. Prudent leveraged lending promotes economic growth and enables many companies to maintain, and even increase, current employment.

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[3] Proposed Guidance on Leveraged Lending, 77 Fed. Reg. 19,417 (proposed Mar. 30, 2012).

[4] 77 Fed. Reg. at 19,424; *see also* Press Release, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Agencies Propose Revisions to Leveraged Finance Guidance (Mar. 26, 2012).

[5] This was comprised of 8,030 credit facilities to approximately 5,400 corporate borrowers, representing a broad range of industries. For example, the SNC portfolio included $700 billion in credit facilities to services companies, $590 billion in loans and commitments to the commodities industry, $435 billion in loans and commitments to financial companies, $385 billion in credit facilities to manufacturers, $164 billion in loans and commitments to the real estate industry, and $225 billion in loans and commitments to distribution companies. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Shared National Credits Program 2011 Review, 4-5, 11 (Aug. 2011).

In addition, if the ability of banks to underwrite and syndicate transactions is reduced, borrowers would likely seek other, less regulated sources of capital, such as non-bank underwriters. Keeping the origination of leveraged finance transactions within the banking system enables the Agencies to monitor and regulate the provision of such loans and decreases the systemic risk that may arise if borrowers abandon bank-syndicated leveraged loans in favor of financing from unregulated lenders.

I. Overview

Underwriting loans, including leveraged loans, has been the core business of banks for many years and managing credit portfolio risk has been a staple of banks' risk management. The LSTA and ABA agree with the Agencies that leveraged finance can present unique risks, and we support the approach of the Proposed Guidance of giving institutions the flexibility to define leveraged finance for themselves. Since the principal elements of leveraged finance policies and procedures are not exceptional, we strongly believe that more modest changes to the current leveraged finance guidance would better enable banks to continue to manage such risks in a safe and sound manner without adding undue burdens. To that end, the comments set forth below are intended to ensure that the Proposed Guidance is as clear, efficient, and useful as possible, both to banks and the Agencies.

The Proposed Guidance requests comments on the necessity and utility of the collection of information set forth in the guidance, the accuracy of the estimates of the cost of such collection, and ways to enhance the quality, utility and clarity of the information and to minimize the burden involved in the production and collection of such information. The LSTA and ABA respectfully submit that the breadth of the Proposed Guidance's information reporting and related limits would be overly burdensome to implement and maintain, and, in some cases, counterproductive to the stated goals of the Proposed Guidance.

The Agencies should reevaluate the cost of compliance and ensure that each suggestion in the Proposed Guidance is, in fact, helpful to the evaluation of risk or management of the leveraged loan portfolio.

The Proposed Guidance sets out a range of detailed monitoring and reporting requirements. These are oftentimes not helpful in the evaluation of risk or management of the leveraged loan portfolio. For example, the Proposed Guidance calls for various broad and overlapping limits, and requires reporting on, and financial analysis of, those deal sponsors that provide no financial guarantees or other credit supports. At significant cost to the banks, the Proposed Guidance will necessitate that banks modify their systems to capture and report on this information. Much of this information would not decrease risk. In fact, it might well increase risk, to the extent that the effort involved in the creation of such documentation and the ongoing monitoring required would take away from more appropriately focused monitoring and management of the leveraged loan portfolio. In light of this, we believe the Agencies estimated costs, which are well below the estimates of our members, are difficult to justify.

The LSTA and ABA also comment on the substantive requirements of the Proposed Guidance as their breadth could degrade the quality, utility, and clarity of the information to be collected.

The Agencies should clarify that the Proposed Guidance sets out certain recommended standards, but that it remains the obligation of each bank's management and board to determine what is appropriate for its institution.

The LSTA and ABA are very concerned that, in a departure from established regulatory practice for guidance, the Proposed Guidance fails generally to note the importance of the discretion of a bank.[6] As a result, there is a risk that certain statements in the guidance may be applied prescriptively, as the equivalent of firm rules. For example, the Proposed Guidance suggests that the ability to repay debt within a fixed number of years should be taken "as a general guide" without giving any consideration to expert judgment about the relevant industry or the specifics of a transaction. Additionally, the Proposed Guidance lists various limits and valuation methods banks should consider. In practice, however, each bank has specific policies and standards in place particular to that bank's leveraged loan portfolio and its leveraged loan risk management. We note that guidance does not have the same force as a rule and that banks should be free to approach leveraged lending in a manner consistent with safe and sound banking practices.

To optimize the value of the guidance for the management of risk arising from loans to entities that carry a high degree of leverage, the Proposed Guidance should maintain flexibility in the definition of "leveraged finance." The Proposed Guidance should not, however, suggest that the term be applied to "fallen angels" and other loans not designated as leveraged at the time of origination, loans to financial vehicles that are not themselves leveraged, asset-based loans, loans held in a bank's trading book, and loans to investment grade companies.

While each bank differs in its management of risk, all banks originate particular types of credit pursuant to particular underwriting standards, such as those that apply to leveraged finance. Loans originated under such guidelines are monitored and managed over time, and the performance of such loans is compared to the objectives of the initial underwriting standards. In this manner, banks determine whether their standards and procedures match the limits on risk that they were designed to reflect; the banks can then modify those standards or procedures to more effectively meet their risk limit objectives. The use of an overly expansive definition of leveraged finance in the Proposed Guidance that banks will be expected to follow may corrupt the data banks collect, and impair its usefulness in managing their leveraged loan portfolios, by making it difficult for banks to see how their leveraged loan portfolios actually perform. This will weaken, rather than enhance, the management of leveraged finance risk and will have the

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6 In contrast to the Proposed Guidance, the OCC's Examiner Guidance for Appropriate Review of Risk Rating Leveraged Lending Credits (SM 2010-3) states that "[m]aking decisions on [Matters Requiring Attention] or proper classification requires substantial judgment and must be based on the specific facts of each situation." Office of the Comptroller of the Currency, Supervisory Memorandum 2010-3, 3 (June 3, 2010).

unintended consequence of undermining the utility of the proposed information collection and reporting requirements.

II. The proposed information collection requirements are substantial burdens without providing clear and corresponding benefits

Under the Proposed Guidance on Reporting and Analytics, a bank's management information systems ("***MIS***") are required to capture specific types of information, such as loan information regarding individual and portfolio exposure across business lines, industry mix and maturity profile of portfolios, exposure and performance by deal sponsors, and risk rating distributions, among other data. The Proposed Guidance directs that management should receive comprehensive reports about such characteristics and trends and that summaries should be provided to the board of directors.[7]

The LSTA and ABA agree with the Agencies on the importance of the capture and provision of useful and understandable information, so that information is beneficial to institutions and consistent with the way institutions manage risk. Effective MIS helps management and boards to fulfill their respective managerial and oversight roles. The LSTA and ABA are concerned, however, that the scope of the proposed information requirements is so broad, and its terms so different from other types of information reported on such loans, that the modification of banks' current MIS and the creation of such reports threaten to impose significant burdens on banks and will not achieve the benefits and transparency the Agencies seek.

A. An overly expansive definition of "leveraged finance" will require extensive modification of existing MIS and undermine the utility of the proposed information collection

The flexibility of the Proposed Guidance gives a bank the ability to develop its own definition of "leveraged finance," and the modifications to the definition outlined in Section III below would significantly reduce the MIS reporting burden suggested by the Proposed Guidance.

The complexity of MIS reporting is related to the definition of "leveraged finance." Expanding the definition to include types of lending not traditionally considered leveraged finance would necessitate that banks create an additional reporting process to meet this definition. With each new and competing definition, banks will be required to expend considerable resources to further modify their MIS to generate the information outlined in the Proposed Guidance.

At the same time, this information will not enhance a bank's ability to manage the risk of its leveraged loan portfolio. Risk managers would not find information on other types of loans

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[7] 77 Fed. Reg. at 19,423.

relevant to management of the leveraged loan portfolio. In practice, other risk matrices capture these other loans. Management therefore will not be able to easily analyze the proposed information to determine the performance of the leveraged loan portfolio or identify and monitor any special risks associated with this portfolio.

B. Reporting on a deal sponsor should be limited to circumstances where a bank relies on a sponsor guarantee or other credit support

Evaluation of a deal sponsor to the full extent suggested in the Proposed Guidance should only be required if a bank relies on a guarantee of, or other credit support from, that deal sponsor when making lending decisions.

The Proposed Guidance suggests that "institutions should develop guidelines for evaluating the qualifications of financial sponsors and implement a process to regularly monitor performance."[8] The Proposed Guidance sets out an extensive list of concepts institutions should include in this evaluation. The Proposed Guidance also suggests a bank's reporting may include exposure and performance of deal sponsors.[9]

Sponsors typically do not provide full contractual guarantees or other credit support for loans to portfolio borrowers. In those circumstances, rational diligence measures can be well short of the full extent of the reporting elaborated in the Proposed Guidance. The generation of such extensive analysis on the qualifications of financial sponsors and subsequent reports on that data in all situations would burden banks that do not receive or rely on guarantees or other credit support from sponsors. The level of analysis and formality of reporting required should be commensurate with the role of each individual sponsor.

C. The Proposed Guidance should confirm that the proposed limits are recommendations

The Agencies should specify that the limits described in the Proposed Guidance are recommendations, and that a bank should set those limits that the bank determines are appropriate for managing its own leveraged loan portfolio.

Limits, including concentration limits, are crucial to the management of risk. Under the Proposed Guidance, banks would generally be expected to set up a limit framework that includes limits for single obligors and transactions, aggregate hold portfolios, aggregate pipeline exposure, and industry and geographic concentrations. Additional limits, such as underwriting limits, are recommended throughout the Proposed Guidance.

The LSTA and ABA believe that many of the limits set out in the Proposed Guidance are, at the same time, too broad and overlapping. Institutions will need to set up, track, and report on

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8 77 Fed. Reg. at 19,424.

9 77 Fed. Reg. at 19,424.

these limits; designing and building workable systems that appropriately code for and capture each of the limits outlined in the Proposed Guidance would be very difficult. In addition, the complexity of the reporting requirements, many of which have no, or, at best, tangential, relevance to risk, will likely obscure the data most relevant to the management of risk. Each bank should be encouraged to establish an appropriate limit structure consistent with its business profile and leveraged loan risk management.

D. The Proposed Guidance significantly underestimates the costs of compliance

We respectfully recommend that the Agencies give more careful consideration to the actual economic costs of the Proposed Guidance and modify the Proposed Guidance to be less exhaustive and prescriptive, acknowledging that appropriate MIS and reporting requirements depend on the business profile of the bank.

The Proposed Guidance will necessitate that banks recode their MIS once again to capture different information and that banks modify their reporting systems. The process of coding for these various standards is both difficult and costly for institutions. Based on other similar and recent system modifications, several of our members have estimated that the initial, one-time set-ups would require, approximately, from 5,000 to 10,000 hours.[10] These estimates assume that the categories of loans discussed below are not included in the definition of "leveraged finance." Inclusion of such loans would cause the number of hours required to be far higher. This 5,000-10,000-hour estimate also does not include the costs associated with reworking systems to correct for errors and the annual costs for the operation and use of these elements of these systems, costs which our members find difficult to estimate. Additionally, as a result of the complexity of the analysis, our member banks predict that the process will become less automated and more manual. This will result in a slower, more expensive process that will not provide the "real time" analysis the Proposed Guidance desires and may be more prone to error. We submit that the range of data recommended should be reexamined to focus on the key parameters required in order to provide management the ability to manage, and the Agencies the ability to supervise the management of, leveraged finance risk.

The Proposed Guidance would also increase costs in terms of management's, and particularly board members', time. We agree that, in order to provide proper oversight, boards should receive periodic reports by management about risks and trends. The Proposed Guidance, however, outlines a widespread list of topics and detailed information that banks should consider including in board reports. The LSTA and ABA believe that the extent of the board reporting described in the Proposed Guidance is so detailed and specific that it will be unhelpful and could even hamper the ability of boards to discharge their oversight duties.

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[10] Given the short comment period, our members were not able to develop more specific numbers, but, as noted, this estimate is based on recent experiences with system modifications to address other, similar regulatory reporting requirements. Given more time, our members may be able to develop more refined estimates, and we would be happy to supplement our comments or discuss this issue further with the Agencies.

Finally, those banks regulated in other jurisdictions will incur additional costs to adapt their leveraged finance policies to the requirements of all jurisdictions.

III. The definition of "leveraged finance" should be defined by each institution and should exclude loans not designated as leveraged at the time of origination, such as "fallen angels," loans to financial vehicles that are not themselves leveraged but engage in leveraged lending, asset-based loans, loans held in a bank's trading book, and loans to investment grade companies

The LSTA and ABA agree that numerous definitions of "leveraged finance" exist throughout the financial services industry, and that each bank should develop its own definition of "leveraged finance."[11] The flexibility provided for in the Proposed Guidance would allow a bank to consider a number of factors generally used by the financial services industry when deciding whether to treat a loan as leveraged, such as the purpose of the transaction.

Such flexibility would enable banks to exclude from the definition of leveraged finance loans to borrowers whose industries ordinarily operate at higher levels of leverage, but who do not otherwise meet a bank's definition of "leveraged finance," such as banks, broker-dealers, specialty finance companies, insurance companies, and public utility companies. Loans to one of these companies do not present the same risks as, for example, a leveraged buyout transaction for an industrial company.

However, loans not designated as leveraged at the time of origination, such as "fallen angels," loans held in a bank's trading book, and loans to investment grade companies should be excluded from the definition of leveraged finance in order to be consistent with the Proposed Guidance's objective of improved management of the leveraged finance portfolio. Further, the term "financial vehicles" requires clarification and, while the exclusion of asset-based loans is sensible, certain other references to such loans in the Proposed Guidance should be conformed.

A. "Fallen angels" and other loans not designated as leveraged at the time of origination

Loans should only be categorized as leveraged loans at origination. Therefore, loans to "fallen angels" and other loans not designated as leveraged at the time of origination should not be included in the definition of "leveraged finance," as they did not become highly leveraged as a consequence of using debt to finance buyouts, acquisitions, or capital distributions.[12]

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[11] Footnote 6 in the Proposed Guidance states that "leveraged finance" refers to the entire capital structure of a borrower, whereas "leveraged loan" refers only to senior loan and letter of credit tranches. 77 Fed. Reg. at 19,420 n.6. The two terms, however, seem to be used interchangeably in the Proposed Guidance, resulting in a lack of clarity in the distinction that the Agencies may be trying to make.

[12] Footnote 8 in the Proposed Guidance states that "[h]igher quality borrowers not initially designated as part of the leveraged portfolio, but which otherwise meet the institution's definition, should be added to the portfolio if their financial performance and prospects deteriorate (i.e., fallen angels)." 77 Fed. Reg. at 19,421 n.8.

Loans to higher grade companies are necessarily underwritten using different standards than would be used for loans originated as leveraged loans. While deterioration in earnings may cause borrowers to slide down an institution's risk rating scale due to performance issues, the reasons for that decline often arise from risk characteristics that have little to do with the risks that are monitored and managed through an effective leveraged lending risk management program.

Rather than having to include "fallen angels" and other loans not designated as leveraged at the time of origination in the leveraged portfolio, such loans should continue to be monitored under the lending policies, standards, controls and management applicable to such loans at the time of origination, even if at some later point the borrowers could technically qualify as leveraged loan borrowers. Like any loan, a non-leveraged loan managed as such will, if it becomes a problem loan, be identified and managed according to appropriate bank policies applicable to problem loans and categorized in accordance with existing standards, including the SNC regime, which the LSTA and ABA believe has worked well in ensuring appropriate oversight of such loans. Having such loans transition from these standard policies and procedures to the leveraged loan policies and procedures as an interim step is more likely to complicate than to assist lenders in the management of their loans and other risks.

Moreover, categorizing and reporting these loans as leveraged loans would only serve to diminish the accuracy and value of the data that the Proposed Guidance would require. The traditional approach of categorizing loans only at inception appropriately isolates and identifies a specific type of lending activity and its risks. The proposed definition would result in the actual amount of leveraged loans being distorted as a result of the underlying borrower's performance or other external factors, rather than a bank's underwriting standards. In addition, specific loans could shift into and out of reporting categories over relatively short periods of time. The LSTA and ABA suggest that such re-categorization of loans over time into different categories be removed from the Proposed Guidance.

B. Loans to financial vehicles that make leveraged loans

*The Agencies should refine the definition of "financial vehicle" and limit its application to situations that present clear leveraged finance risks, given the wide range of entities that might be deemed to be financial vehicles and the range of financial characteristics of such borrowers. The Proposed Guidance should exclude from leveraged finance those loans to financial vehicles that themselves do not meet the bank's definition of a leveraged transaction, such as business development companies ("**BDCs**") or other similarly structured transactions.*

The Proposed Guidance suggests that the definition of "leveraged finance" "should include the bank's exposure to financial vehicles, whether or not leveraged, that engage in leveraged finance activities."[13] However, the Proposed Guidance provides no clarity as to what is meant by the term "financial vehicle."

As currently formulated, the vagueness of the term would require a bank lending to any type of financial vehicle to analyze that entity's business under the Proposed Guidance. Conceivably, if a portion of a borrower's business met a bank's definition of leveraged finance, then the loan would need to follow the standards in that bank's leveraged loan policies. We believe that the Proposed Guidance inappropriately asserts that any loan, whether a leveraged loan or not, to any financial vehicle that engages in leveraged lending be categorized as a leveraged loan, particularly given that loans to financial vehicles will be subject to specific underwriting or risk criteria relevant to various types of vehicles.

The LSTA and ABA may wish to submit additional comments once the Agencies clarify the meaning of the term "financial vehicle."

C. Asset-based loans

The Proposed Guidance's exclusion of asset-based loans is consistent with other regulatory distinctions between leveraged finance and asset-based lending, and other references to asset-based lending in the Proposed Guidance should be modified to conform on this point.

The Proposed Guidance states with respect to leveraged lending underwriting standards that "[s]tandards for asset-based loans should also outline expectations for the use of collateral controls (e.g., inspections, independent valuations, and lockbox), other types of collateral and account maintenance agreements, and periodic reporting requirements."[14] Shortly thereafter, the Proposed Guidance states that "[n]either are [the proceeding standards] meant to discourage well-structured stand-alone asset-based credit facilities to borrowers with strong lender monitoring and controls, for which banks should consider separate underwriting and risk rating guidance."[15]

We agree with the conclusion that such loans, including asset-based loans, equipment loans and leases, inventory finance, and commercial real estate financing, should not be subject to the final leveraged lending guidance, because such loans provide lenders with more structure and collateral and protections than leveraged loans. We recommend the Agencies revise the first reference in order to remove this apparent inconsistency.

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[13] 77 Fed. Reg. at 19,421.

[14] 77 Fed. Reg. at 19,422.

[15] 77 Fed. Reg. at 19,422.

D. Trading portfolio

The Agencies should modify the Proposed Guidance to exclude coverage of a leveraged loan held in a bank's trading portfolio.

The Proposed Guidance also appears to apply to leveraged loans that a bank holds in its trading portfolio. While holding any loan in a trading portfolio carries risk, such as counterparty credit risk and market risk, the management of these risks is separate and quite different from the management of credit risks associated with a loan portfolio. A bank's management of these exposures is also quite different. For example, a trading position may (i) have been acquired at a discount to par, (ii) be intended to be held for a short term or be acquired for market making activities, and/or (iii) be hedged in whole or in part. Trading desks also generally operate without access to the same databases of information that underwriters use to underwrite and manage loans and the loan portfolio. As a result of these differences, distinct regulatory requirements attach to loans held in the trading portfolio. A bank's exposure to trading portfolio risk is generally subject to higher capital charges and separate accounting and reporting requirements.

Requiring that the underwriting and other substantive standards in the Proposed Guidance apply to such exposures has little relevance to the risk that such trading positions represent. The risk inherent in such positions will be based, in part, on the prices such loans were acquired at, which may vary across the portfolio. Including such positions in the reporting on the loan portfolio would, therefore, substantially distort the bank's leveraged loan risk.

E. Loans to investment grade companies

To conform with previous guidance, the Proposed Guidance should acknowledge that loans to investment grade companies are excluded from the definition of "leveraged finance."

The 2008 Comptroller's Handbook on Leveraged Lending included as a condition in the definition of leveraged lending "[b]orrowers rated as non-investment grade companies with a high debt to net worth ratio,"[16] thereby excluding loans to investment grade companies. We recommend that the Proposed Guidance specifically acknowledge that it is limited to non-investment grade companies or that it does not cover investment grade companies.

IV. Qualitative assessments of risk are crucial in underwriting loans; therefore, underwriting standards regarding a borrower's ability to repay should include industry norms

The LSTA and ABA respectfully submit that safe and sound underwriting decisions are a function not only of quantitative evaluations, but also of qualitative judgments that provide a more nuanced, accurate and, therefore, complete assessment of risk. These qualitative judgments

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16 Office of the Comptroller of the Currency, Comptroller's Handbook: Leveraged Lending, 2 (Feb. 2008).

draw upon the experience and judgment of credit officers and industry experts and the expertise of bank examiners who work on-site and intimately understand the businesses, loan portfolios, processes, and people of the banks they examine.

The finalized guidance should confirm the ability of banks to exercise these qualitative judgments and also reincorporate the current industry leverage standard, as set out below, as one of the alternative tests for a borrower's ability to repay.

The Proposed Guidance's provision that loans should be underwritten only to borrowers whose base cash flow projections show the ability to repay 100% of senior secured debt or at least 50% of total debt over a five-to-seven year period negates the role of a bank's credit underwriting personnel (including credit officers and market experts) in making qualitative judgments about the re-financibility of such loans. Unlike the Proposed Guidance, the OCC's SM 2010-3 provides a third, additional, alternative consideration: a borrower's ability over a five-to-seven year period to de-leverage to the relevant industry average (in the sense of debt/EBITDA).[17]

This third criterion, which is not included in the Proposed Guidance, recognizes that such de-leveraging to an industry average is an appropriate alternative measurement. It has been applied by the OCC's examiners and, in the experience of our members, is both a workable and reasonable standard that is flexible enough to reflect the fact that absolute leverage levels and repayment schedules will vary by industry and by transaction within an industry. Such a standard takes into account lenders' judgment about the varying abilities of companies in different businesses to generate free cash flows sufficient to service differing levels of debt over extended periods of time.

The removal of this alternative will mean that, in many cases, banks will be unable to make the types of leveraged loans that they make today, as each could, *ab initio*, be deemed to be a criticized loan. Thus, banks would be proscribed from lending in a safe and sound manner to a significant portion of the borrowers in the current market for such loans.

V. Banks have no fiduciary duties in underwriting and distributing leveraged finance transactions

The assertion of a fiduciary obligation on the part of banks is incorrect, and the Proposed Guidance should be revised to rely solely upon the "reputational risk" factor for this point.

In the Proposed Guidance, the Agencies warn banks that an "institution's apparent failure to meet its legal or fiduciary responsibilities in underwriting and distributing transactions can damage its reputation and impair its ability to compete."[18] The law is clear that no party to a

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[17] Office of the Comptroller of the Currency, Supervisory Memorandum 2010-3, 2 (June 3, 2010).

[18] 77 Fed. Reg. at 19,424.

credit transaction has fiduciary responsibilities to any other party in such a transaction. Allowing the reference to "fiduciary responsibilities" to remain in the guidance may create an expectation in the market that such duties exist, when in fact there are none. This unnecessarily increases the risk of arranging such loans, would subject arranging banks to an increased risk of litigation and could induce institutional lenders to improperly rely on arrangers and agents.

Parties to a syndicated credit agreement contractually agree that the agent has no fiduciary duty or other implied or express obligation or duty, except those ministerial obligations expressly set forth in the loan documents. In addition, each lender party to a syndicated credit agreement acknowledges that it has independently, and without reliance upon the agent or any other lender, made its own analysis and decision to enter into the credit agreement and will continue to make its own decisions under that agreement. On several occasions the Agencies have emphasized the importance of participants making their own independent analyses and not relying on the representations of an arranging bank.[19]

Courts generally uphold language in credit agreements that explicitly disclaims (i) a fiduciary relationship; (ii) disclosure obligations of the agent; (iii) agent liability for anything other than gross negligence and willful misconduct; and (iv) any liabilities, obligations, or duties of an arranger. This is especially true in the context of transactions involving sophisticated financial institutions, such as in the leveraged finance market.[20] Institutional lenders in the leveraged finance market generally have substantial assets under management, have experience in the loan market, and knowingly assume the risks inherent in leveraged finance transactions.

While the LSTA and ABA do not agree that banks have any such fiduciary responsibility, we do agree with the Agencies that banks should be cautious about distributing poorly underwritten transactions. The Agencies should not assume, however, that arrangers of loans that are targeted to institutional lenders do no diligence or credit analysis on borrowers. In fact, extensive due diligence and modeling by arrangers and their bank affiliates precede the structuring and marketing of a transaction. Considerations of reputation and franchise risk are important elements in the conduct of such due diligence.

Conducting the necessary due diligence to ensure that banks do not distribute poorly underwritten transactions does not mean that banks should not underwrite and market higher risk loans. The institutional syndicated loan market is a professional market with sophisticated

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[19] Interagency Statement on Sales of 100% Loan Participations (Apr. 10, 1997) (with respect to 100% loan participations); Office of the Comptroller of the Currency, Banking Circular 181 (Aug. 2, 1984) ("[T]he practices outlined in this Circular are illustrative of those principles of prudent banking which generally apply to any multibank lending transaction. For example, a prudent member of a loan syndication would obtain full and timely credit information to conduct an informed and independent analysis of the credit in a manner consistent with its formal lending policies and procedures.").

[20] *See, e.g.*, *Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co.*, 919 F.2d 510 (9th Cir. 1990); *Unicredito Italiano SPA v. JPMorgan Chase Bank*, 288 F. Supp. 2d 485 (S.D.N.Y. 2003); *Banco Espanol de Credito v. Sec. Pac. Nat'l Bank*, 763 F. Supp. 36 (S.D.N.Y. 1991), *aff'd*, 973 F.2d 51 (2d Cir. 1992).

buyers. Oftentimes, these institutional lenders have entirely different and legitimate risk appetites than banks and, in fact, actively seek out assets that provide higher returns. Arrangers and borrowers negotiate the terms of these loans and often agree to a price and covenant "flex" to ensure that the loans meets the demands of institutional lenders. While we recognize that a bank will occasionally be required to hold temporarily on its books a loan targeted to institutional lenders, that risk is addressed through robust management of the bank's pipeline risk.

VI. The Proposed Guidance's discussion of valuation standards requires clarification

The Agencies should confirm that a bank need not rely upon more than a single, appropriate valuation methodology.

The Proposed Guidance describes a number of methods for determining enterprise value.[21] The LSTA and ABA wish to confirm that none of these methods, including the "capitalized cash flow" and "discounted cash flow" methods, would be required in any given scenario. Banks commonly use other methods to determine total enterprise value in leveraged finance transactions, including, for example, EBITDA multiples paid for comparable businesses. These methods have been proven to develop a credible enterprise valuation. In general, institutions should be able to select the valuation metric they believe is most relevant to the underwriting process. Therefore, requiring banks to employ multiple enterprise valuation appraisals would be inefficient and would not improve the quality of underwriting.

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For the foregoing reasons, the LSTA and ABA respectfully request that the Agencies revise the Proposed Guidance to clarify that, while it identifies and details a list of standards, the Proposed Guidance is, in fact, guidance, and a bank's management and board should ultimately determine which of those standards are appropriate for its institution to operate in a safe and sound manner given its business profile.

As to the scope of the Proposed Guidance, the definition of "leveraged finance" should exclude those loans described above that do not present the same risks as leveraged finance. The use of such an expansive definition will diminish the quality of information and management of the leveraged loan portfolio, which may serve to undermine the utility of the proposed collection and reporting of information. Additionally, the Agencies should ensure that all aspects of the Proposed Guidance both improve the quality of underwriting and risk rating and are consistent with relevant legal requirements.

As noted above, leveraged finance plays an important role in making credit available to borrowers. As they have for years, banks can meet this demand by prudently lending to companies attempting to restructure or expand their businesses. This will in turn promote

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[21] 77 Fed. Reg. at 19,422.

economic growth and enable many companies to maintain, or even increase, current employment. We urge the Agencies to reconsider those provisions noted in this comment in order to strengthen the ability of banks to provide such credit, while operating in a safe and sound manner.

We sincerely appreciate your consideration of our comments and stand ready to provide any additional information you believe might be useful. 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,

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