From:	Mike Clarke
To:	Regs.Comments; regs.comments@federalreserve.gov; comments@FDIC.gov
Subject:	Comment Letter - Proposed Leveraged Lending Guidance
Date:	Monday, May 14, 2012 5:40:12 PM
Attachments:	Access NB Comment Ltr Leveraged Lending May 14 2012.pdf

Sent via OCC Secure Mail
May 15, 2012

Office of the Comptroller of the Currency
Attention: Louise Francis, Commercial Credit Technical Expert
250 E Street SW, Mail Stop 2-3
Washington, DC 20219
Via e-mail: regs.comments@occ.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Via e-mail: regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/ Legal
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Via e-mail: comments@FDIC.gov

RE: **Proposed Leveraged Lending Guidance**
OCC Docket Number OCC-2011-0028
FRB Docket Number OP—1439

Dear Ladies and Gentlemen:

Like the prior Guidance on this subject, the proposed Guidance is too vague and unclear as to application of the Guidance to particular banks and loan transactions. I have two areas of concern to address:

Applicability to Community Banks

The Guidance could easily be misinterpreted by Examiners to ask a community bank to document and prove why certain transactions are not considered leverage finance as opposed to documenting transactions that clearly are leveraged finance. Unless stated otherwise, the burden of proof that any transaction is NOT leveraged finance will rest with the bank. Therefore all business loans will need to be evaluated on measures that are not presently customary for community banks. As a point of comparison, we have recently seen this type of negative proof documentation applied towards the identification of Troubled Debt Restructurings and find the documentation and burden that results outweigh any potential benefit to effective Supervision, Safety and Soundness.

I propose an exclusion of this Guidance for “community banks” of less than $10 billion in assets unless the bank’s primary federal regulator observes systemic activity that warrants its application. This exclusion is easy to understand and should be simple to enforce should there be a level of activity that warrants application. The Examiners can monitor and probe on this subject through the requirement that all banks establish and maintain an effective concentration risk identification and management program.

<u>Definition of Leveraged Finance</u>

As currently proposed, the definition of” Leveraged Finance” as a multiple of debt to EBITDA is inappropriate and will be difficult to apply in any consistent manner.

The lending personnel of most community banks are not equipped to identify leveraged finance under the proposed definition. In most training manuals for commercial lending, the concept of leverage is focused on the balance sheet definitions of leverage, not cash flow leverage.

Most community banks do not evaluate credit in this manner and do not possess the MIS systems to track it. Furthermore, the guidance fails to adequately define how the ratios are measured:

1. Is the leverage ratio applied to historical performance?
2. Is the leverage ratio applied to prospective performance?
3. What if an “off period” triggers the leverage ratio threshold for a business that generally is not considered leveraged?
4. Does this apply to real estate debt that may be capitalized on the balance sheet of an operating business?
5. Does it apply to entities engaged in the trade of real estate ownership or development? These types of businesses do not lend themselves to this type of measure.
6. Does this apply to personal and professional service businesses, such as medical and dental practices, that often have the indicated level of leveraged EBITDA in their formative years and may include real estate debt that is wrapped into permanent working capital?
7. Does this apply to small businesses that are franchisees who enter the franchise business with this indicated level of cash flow leverage?

I recommend that you <u>consider exclusions in the revised definition</u> such as:

1. Loan Size – the loan must be in excess of some level, perhaps $10 or $20 million;
2. Loans that carry a government guaranty such as programs offered by the SBA, USDA, and the DOE or other forms of credit enhancement that represent self-evident collateral such as cash securities or letters of credit issued by a creditworthy counter-party;
3. Real Estate – any loan or business that contains real estate as a primary component of the collateral; and
4. Collateral – the loan is deemed to be adequately secured by assets actively used in the trade or business and the collateral or secondary source of repayment is not the

"enterprise value" of the business. In other words, a loan must contain an "air ball" component that is significant in relation to the credit in order for the loan to be considered "leveraged finance".

If you need any clarification of these comments, please contact me via e-mail or phone at 703-871-2100.

We appreciate your efforts to ensure a safe and sound banking system.

Sincerely,

Michael Clarke
President and CEO

Access National Bank
progressive business banking
1800 Robert Fulton Dr Suite 310
Reston, Virginia 20191
703-871-2101 fax 703-766-3385

ticker: ANCX

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I recommend that you consider exclusions in the revised definition such as:

1. Loan Size – the loan must be in excess of some level, perhaps $10 or $20 million;
2. Loans that carry a government guaranty such as programs offered by the SBA, USDA, and the DOE or other forms of credit enhancement that represent self- evident collateral such as cash securities or letters of credit issued by a creditworthy counter-party;
3. Real Estate – any loan or business that contains real estate as a primary component of the collateral; and
4. Collateral – the loan is deemed to be adequately secured by assets actively used in the trade or business and the collateral or secondary source of repayment is not the "enterprise value" of the business. In other words, a loan must contain an "air ball" component that is significant in relation to the credit in order for the loan to be considered "leveraged finance".

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We appreciate your efforts to ensure a safe and sound banking system.

Sincerely,

Michael Clarke
President and CEO

From:	John Russell
To:	Regs.Comments; "regs.comments@federalreserve.gov"; "comments@FDIC.gov"
Cc:	"peter@barashassociates.com"
Subject:	Leveraged Lending Guidance Comments; OCC-2011-0028; OP-1439
Date:	Friday, June 08, 2012 11:02:04 AM
Attachments:	Comments of ASA and RICS Americas RE Leveraged Lending Proposed Rulemaking.pdf

Pleased find attached the joint comments of the American Society of Appraisers and RICS Americas regarding the above-captioned proposal. If you have any questions about our views or would like to arrange a meeting, please contact our government relations representative in Washington, DC, Peter Barash (202-466-2221, peter@barashassociates.com) or John D. Russell, Director of Government Relations for the American Society of Appraisers (703-733-2103, jrussell@appraiser.org).

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June 8, 2012

Office of the Comptroller of the Currency, Treasury
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

Re: Leveraged Lending Proposed Guidance

Dear Sir or Madam:

The American Society of Appraisers (ASA) and the U.S. region of the Royal Institution of Chartered Surveyors (RICS Americas), representing thousands of professional appraisers credentialed in business valuation and commercial real estate appraisal practice, appreciate the opportunity to comment on the "Proposed Guidance on Leveraged Lending." [1] Although our comments focus on the sections of the Guidance involving "Valuation Standards," we endorse the need for and the public policy purposes of the proposal in its entirety.

I. Executive Summary

(1)**The Appraisal Portion of the Leveraged Lending Guidance Lacks Provisions Relating To Appraiser Qualifications, Appraiser Independence and Appraiser Adherence to Generally-Accepted Appraisal Standards. These Missing Elements Undermine the Reliability of Enterprise Valuations and Their Usefulness in Helping to Ensure Safe and Sound Leveraged Loans:**

While our organizations strongly support the important purposes of the proposal's valuation provisions, those provisions are missing crucial elements without which their effectiveness as an aid to ensure safe and sound leveraged lending are fundamentally undermined. Those missing elements and our recommendations on how the omissions can be easily remedied are described below:

First, the valuation provisions do not address the crucial issues of appraiser qualifications and appraiser independence for those providing enterprise valuations in connection with leveraged loans. Requirements relative to the qualifications and independence of appraisers are essential to ensure that appraisers are competent and that their conclusions of value are objective and free from any conflicts of interest;

Second, the valuation provisions do not address the imperative of appraiser adherence to generally-accepted appraisal standards. Adherence to such standards is necessary to ensure

[1] ASA and RICS Americas are professional appraisal organizations which teach, test and credential their members for professional appraisal practice in business valuation and in commercial and residential real estate. Both organizations require their members to adhere to a strict and enforceable Code of Ethics. In addition, ASA awards a credential in personal property appraising, including the valuation of machinery, equipment and technical specialties. ASA is widely regarded as the leading business valuation professional appraisal organization in the U.S.

uniformity in the valuation approaches, methods and procedures utilized for business enterprise appraisals in leveraged lending situations. We believe that requiring adherence to generally-accepted appraisal standards is an essential safeguard against advocacy appraisals.

While the omissions cited above seriously undermine the purpose and effectiveness of the Guidance's valuation provisions (and the potential usefulness of the Guidance itself), there are ready-made, virtually off-the-shelf solutions available that are easily includible in the Leveraged Lending Guidance. Those solutions can be found in the provisions of the federal banking agencies Interagency Appraisal Guidelines and in IRS guidance governing "Qualified Appraisers" and "Qualified Appraisals". Both documents contain provisions which establish appraiser qualifications and independence requirements and ensure adherence to generally-accepted appraisal standards. These provisions are directly relevant to and needed in the Appraisal Standards portion of the Leveraged Lending Guidance; and, they can be readily incorporated into it.

(2)The Credit Review Capabilities of Lenders Should Include Appraisal Expertise:

Given the inherent riskiness of leveraged loans, the Leveraged Lending Guidance properly emphasizes the importance of the credit review capabilities of lenders, including the ability to effectively review the "valuation methodologies" relied on during the loan underwriting process. While the Guidance, as proposed, appropriately states that lenders should "staff their internal credit review function appropriately," it does not address the particulars of staff expertise necessary to review appraisals. When the Guidance is issued in final form, we believe it should encourage lenders to include, as members of their audit team (including third parties hired by the lender), individuals who are competent to review appraisals, particularly going concern appraisal reports which typically contain complex analyses involving the value of an operating business, the business ownership interests and the intangible assets.

In this regard, we recommend that the Guidance ensure that members of a lender's audit team responsible for reviewing enterprise appraisals possess valuation qualifications comparable to those required of appraisers who perform valuations during the loan underwriting process; and, that these individuals be independent of the lender's loan production function. The Interagency Appraisal Guidelines include such provisions that are specifically directed at lenders; and, they provide an ideal template for inclusion in the Leveraged Lending Guidance. We believe it is self-evident that individuals working for the lender in an appraisal review or audit capacity should have the credentials and independence necessary to perform that job responsibly.

(3)The Appraisal Standards Portion of the Guidance Should Include Commentary Addressing the Fact that Under Certain Circumstances A Going Concern Valuation By A Business Appraiser May Require the Services of an Appraiser Credentialed to Value the Firm's Tangible Assets, Such as Real Estate, Machinery and Equipment and, Possibly, The Non-Fixed Assets (e.g., Furnishings) In Buildings Owned or Leased by the Firm Being Valued.

The issue of whether the tangible assets of an operating business should be separately valued as part of a going concern appraisal – or whether an asset-based approach to value is warranted –

depends on the judgment of the business appraiser and is further dependent on the applicable standard of value, the purpose and intended use of the valuation and all other relevant factors. As a general matter, for example, the asset-based approach should be considered in valuations conducted at the enterprise level when they involve an investment or real estate holding company or a business appraised on a basis other than as a going concern.[2] We understand that the Leveraged Lending Guidance is not an appropriate vehicle for detailed commentary on when and how the tangible assets of a firm should be separately valued in the context of a going enterprise appraisal (the business valuation standards and professional journals of the American Society of Appraisers and other professional organizations which credential business appraisers) include appropriate discussion and guidance on this issue. Nevertheless, we believe that those most affected by the "Valuation Standards" portion of the Guidance (i.e., appraisers and lenders who use their services) would benefit from a recognition, in Guidance commentary, that enterprise appraisals performed in connection with underwriting a leverage loan to an operating business may well require the services of a real estate or machinery and equipment appraiser to value the firm's tangible assets. That decision is and should continue to be made by the business appraiser performing the going concern valuation and who is ultimately responsible for its integrity.[3]

II. <u>Discussion</u>

A. <u>Competent Business Enterprise Appraisals Can Greatly Assist Lenders In Measuring Leveraged Loan Risk</u>:

Our organizations agree with a central premise of the Leveraged Lending Guidance that a competent and independent business enterprise appraisal will provide financial institutions engaged in leveraged lending with important information necessary to underwrite such loans in a safe and sound manner. Our business appraisers recognize that the appraisal reports typically prepared for and about the value of going concerns, including their tangible and intangible assets, contain conclusions, analyses and data that can be invaluable to a lender's (as well as a regulator's) understanding of leveraged loan risk. The proposal correctly recites the several categories of information and analysis that an appraisal of enterprise value will provide leveraged lenders (e.g., evaluating the feasibility of a loan request; determining the debt reduction potential of planned asset sales; assessing a borrowing firm's ability to repay a loan and access the capital markets). The Guidance also accurately describes the general approaches for valuing closely held businesses.

The "Credit Review" portion of the proposed Guidance states that due to the elevated risk inherent in leveraged financing, financial institutions should "have a strong and independent credit review function" and that reviews should include the evaluation of "valuation

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[2] The "Business Valuation Standards" of the American Society of Appraisers describes the asset-based approach as "a general way of determining a value indication of a business…using one or more methods based on the value of the assets net of liabilities." It further states that "The asset based approach should be considered in valuation conducted at the enterprise level and involving (a) An investment or real estate holding company [and] (b) A business appraised on a basis other than as a going concern."

[3] To the extent that there are any unresolved issues regarding the facts and circumstances under which a going concern appraisal should draw on the services of another appraisal discipline to value the tangible assets of the firm being valued, they should be addressed by the appraisal profession in conjunction with The Appraisal Foundation's boards.

methodologies." We concur and point out that in order for a leveraged lender's credit review staff or third party contractors to properly evaluate enterprise or other appraisals performed during the underwriting process, they should possess the qualifications and independence of the appraisers performing loan origination appraisals. Given the fact that lenders often rely on enterprise value, including the value of the tangible and intangibles assets of the borrowing firm to determine risk, we believe that the appraiser qualifications and independence provisions included in the final Leveraged Lending Guidance, should be applied, as well, to the appropriate members of the lender's credit review team.

B. While Our Organizations Strongly Support the Thrust and Purposes of the Guidance's Valuation Standards, They Lack Elements Necessary to Ensure Their Reliability and Effectiveness

As proposed, The Valuation Provisions of the Leveraged Lending Guidance Fail To Address the Need For Appraiser Qualifications, Appraiser Independence and Appraiser Adherence To Generally-Accepted Appraisal Standards: Although the Guidance properly requires that enterprise valuations be "performed or validated by qualified persons independent of the origination function," it nowhere prescribes or even addresses the valuation skill-sets (including adherence to generally-accepted appraisal standards) necessary to ensure competent going concern appraisals. It also fails to establish appraiser "independence" requirements that would ensure that conclusions of value are objective.

Our organizations strongly believe that if the Guidance's valuation standards fail to include these elements, the reliability and effectiveness of going concern appraisals will be seriously compromised. While it is standard practice for private sector users of business appraisal services to only retain individuals with well-established professional appraiser credentials (indeed, this may have been contemplated by the drafters of the proposed Guidance), the Guidance should make this explicit and not leave it to chance.

RECOMMENDATION:

Our Organizations Strongly Recommend the Inclusion of Appraiser Qualifications, Appraisal Standards and Appraiser Independence Provisions In the Leveraged Lending Guidance. Well Known Templates for These Provisions Already Exist at Federal Agencies, Providing Off-the-Shelf Solutions to These Missing Elements –

The templates for each of the missing appraisal elements of the Leveraged Lending Guidance currently exist both in the **Interagency Appraisal Guidelines** promulgated by the federal financial institutions regulatory agencies in December 2010[4] and in **the Internal Revenue Service Appraisal Guidance** for valuing non-cash charitable contributions and for several other tax purposes.[5] Both documents establish appraiser qualification requirements. Both documents require that appraisers adhere to generally-accepted appraisal standards (i.e., the Uniform

[4] The Interagency Guidelines were published by the federal banking agencies in the Federal Register of December 10, 2010.

[5] IRS Notice 2006-96, "Guidance Regarding Appraisal Requirements For Non-Cash Charitable Contributions" and for other tax purposes.

Standards of Professional Appraisal Practice or, in the case of IRS, USPAP or other generally-accepted standards that are consistent with the substance and principles of USPAP). Both documents include independence provisions which require appraisers to be independent of any financial or other interests that could influence their conclusion of value.

The Interagency Appraisal Guidelines, which govern the performance of real estate appraisals by real estate appraisers in connection with real estate-collateralized lending by regulated financial institutions, establish **appraiser independence** and **appraisal standards** requirements that are fully relevant to and compatible with business enterprise appraisals of going concerns addressed in the Leveraged Lending Guidance. Clearly, the real estate appraiser qualifications provisions of the Interagency Appraisal Guidelines are not applicable to the valuation skill-sets needed by business appraisers to value going concerns and intangible property. However, they do become relevant in situations where a business enterprise appraiser, performing a going concern valuation, determines that the services of a real estate appraiser are required to value the real estate assets of the firm being valued.

The IRS Guidance, which specifies the valuation skill-sets necessary to be considered a "Qualified Appraiser" for tax-related valuations of going concerns and intangible property (as well as for other categories of property such as machinery and equipment), is directly relevant to the qualifications of business appraisers and other non-real property appraisers in connection with leveraged lending. IRS' definition of "Qualified Appraiser" specifically covers business appraisers (as well as other non-real estate appraiser disciplines) and is an appropriate template for inclusion in the Leveraged Lending Guidance.

As stated above, our organizations believe that the important missing elements in the valuation provisions of proposed Leveraged Lending Guidance are readily available from the appraisal provisions found in the Interagency Appraisal Guidelines and IRS' Appraisal Guidance. Our review of the two documents leads us to the following conclusions:

Adherence to generally-accepted appraisal standards and appraiser independence: With respect to the imperatives of the appraiser's adherence to generally-accepted appraisal standards and the appraiser's independence from conflicts-of-interest, we believe that the provisions of both the Interagency Appraisal Guidelines and IRS' Appraisal Guidance are fully compatible with the purposes of the Leveraged Lending Guidance and that provisions in either document can form the basis for similar provisions in the Leveraged Lending proposal; and,

Qualifications For Business Appraisers: With respect to the qualifications of business appraisers (and other non-real property appraisal disciplines), the appropriate template is found in the IRS Appraisal Guidelines whose definition of a "Qualified Appraiser" establishes clear and effective qualification requirements for business appraisers and personal property appraisers. While these qualification requirements are directed at appraisers who provide tax-related valuation services, the "Qualified Appraiser" definition is entirely appropriate (and we think essential) for the Leveraged Lending Guidance and its safety and soundness purposes. [6]

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[6] The Internal Revenue Service's definition of a "Qualified Appraiser" states that "the term 'qualified appraiser' means an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in (cont.)

<u>Qualifications For Real Estate Appraisers</u>: The provisions of the Interagency Appraisal Guidelines relating to real estate appraisal practice provide the appropriate template for compliance with the Leveraged Lending Guidance <u>when the business appraiser conducting a going concern valuation of a firm determines that a separate valuation of real estate assets is required</u>.

III. Additional Discussion

IRS' "Qualified Appraiser" definition is important in the context of the banking agencies' Leveraged Lending proposal because it establishes qualifications for non-real property appraiser disciplines (i.e., business appraisers and personal property appraisers) – something the Interagency Appraisal Guidelines does not do. Because the Tax Code requires valuations of all categories of property for various Income, Estate and Gift Tax purposes and because IRS wanted to improve the reliability of appraisals prepared for and filed by taxpayers, it determined that it needed a definition of "Qualified Appraiser" that encompassed all appraiser disciplines and all categories of intangible and tangible property (e.g., business enterprise appraisals, including intangibles; machinery and equipment appraisals; art appraisals). For business appraisers and personal property appraisers, IRS' definition of a "Qualified Appraiser" requires individuals to have an appraisal credential from a recognized professional appraisal organization that is awarded on the basis of demonstrated competency and verifiable educational achievement relating to the type of property for which the appraisal is performed (there are several other

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regulations prescribed by the Secretary, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance. Section 170(f)(11)(E)(iii) further provides that an individual will not be treated as a qualified appraiser unless that individual (1) demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and (2) has not been prohibited from practicing before the Internal Revenue Service by the Secretary under § 330(c) of Title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal." 03 *Transitional terms-qualified appraiser* (1) *Appraisal designation*. An appraiser will be treated as having earned an appraisal designation from a recognized professional appraiser organization within the meaning of § 170(f)(11)(E)(ii)(I) if the appraisal designation is awarded on the basis of demonstrated competency in valuing the type of property for which the appraisal is performed. (2) *Education and experience in valuing the type of property*. An appraiser will be treated as having demonstrated verifiable education and experience in valuing the type of property subject to the appraisal within the meaning of § 170(f)(11)(E)(iii)(I) if the appraiser makes a declaration in the appraisal that, because of the appraiser's background, experience, education, and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued. *See also* § 1.170A-13(c)(5). (3) *Minimum education and experience*. An appraiser will be treated as having met minimum education and experience requirements within the meaning of § 170(f)(11)(E)(ii)(I) if — (a) *For real property* (i) For returns filed on or before October 19, 2006, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A-13(c)(5) to make appraisals of the type of property being valued. (ii) For returns filed after October 19, 2006, the appraiser is licensed or certified for the type of property being appraised in the state in which the appraised real property is located. (b) *For property other than real property* — (i) For returns filed on or before February 16, 2007, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A-13(c)(5) to make appraisals of the type of property being valued. (ii) For returns filed after February 16, 2007, the appraiser has (A) successfully completed college or professional-level coursework that is relevant to the property being valued, (B) obtained at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued, and (C) fully described in the appraisal the appraiser's education and experience that qualify the appraiser to value the type of property being valued.

related requirements). For real property appraisers, IRS' "Qualified Appraiser" definition is generally similar to the qualified appraiser provisions of the Interagency Appraisal Guidelines. It requires, among other things, a Certification or License from a state appraiser licensing agency depending on the type and complexity of real estate or interests in real estate being valued for tax purposes.

We believe the "Valuation Standards" provisions of the Leveraged Lending Guidance also must be relevant to all appraiser disciplines and to a wide variety of property whose value could affect a firm's ability to repay a leveraged loan; and a lender's assessment, during the underwriting process, of risk. We regard IRS's appraisal guidance as an excellent and readily available template for the non-real property appraiser qualifications provisions; and, we respectfully recommend that it become part of the Leveraged Lending Guidance.

What the banking agencies' Interagency Appraisal Guidelines and the IRS' definition of a "Qualified Appraiser" have in common is that they both address, in considerable detail, the valuation qualifications necessary to create a reliable presumption that the individual performing the appraisal will do so competently. They also share the basic ingredients of what constitutes a "Qualified Appraiser": Valuation-specific experience, training and education (including continuing education) adherence to Ethics requirements and, often, the ability to pass an exam. For business and personal property appraisers, a professional designation awarded by a recognized professional appraisal organization based on an individual's compliance with these factors is the appropriate qualifications standard. For appraisers of commercial real estate, both the Interagency Appraisal Guidelines and IRS guidance require a general certification awarded by a state appraiser licensing agency pursuant to Title XI of FIRREA. A real estate appraiser credential from a recognized professional appraisal organization would be part of the appropriate qualifications for valuing real estate or real property.

With respect to the issue of appraiser independence, we believe that the relevant provisions of the agencies' Interagency Appraisal Guidelines, as strengthened by the Dodd-Frank statute's appraiser independence provisions, are an appropriate template for adding substance to the independence requirements of the Leveraged Lending guidance; and are easily adaptable for that purpose. IRS' Appraisal Guidance also requires that the appraiser is independent of any conflicting interests.

Importantly, the appraiser qualifications and independence provisions of the federal Interagency Appraisal Guidelines not only govern the conduct of the appraiser involved in the loan origination, they also cover employees or contractors of the lender who are involved in any way in the appraisal process, including the lender's audit and review function relative to the appraisal.[7] As stated earlier in our comments, the valuation provisions of the Leveraged Lending

[7] For example, the Interagency Guidelines state that "An institution should establish qualification criteria for persons who are eligible to review appraisals…Persons who review appraisals…should be independent of the transaction and have no direct or indirect interest, financial or otherwise, in the property or transaction, and be independent of and insulated from any influence by loan production staff. Reviewers also should possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction, type of real property, and market. Further, reviewers should be capable of assessing whether the appraisal…contains sufficient information and analysis to support the institution's decision to engage in the transaction." "An institution should assess the level of in-house expertise available to review appraisals for complex projects, (cont.)

proposal should also include guidance governing the independence of lender employees or contractors involved in the appraisal function.

Confidence in the competency of business appraisers and in the objectivity of their going concern valuations will be seriously undermined if the Leveraged Lending guidance fails to specifically address appraiser qualifications and independence and adherence to USPAP or standards consistent with the substance and principles of USPAP.

IV. Conclusion

We believe that if the valuation provisions of the Leveraged Lending Guidance are strengthened along the lines our organizations recommend, the Guidance will represent a significant safety and soundness regulatory reform. We hope our comments are helpful to your agencies as you seek to perfect the Guidance and issue it in final form. Our organizations would be pleased to lend our assistance to your agencies in any way you think useful as you consider changes to the valuation provisions of the Guidance. We would also welcome an opportunity to meet with representatives of your agencies to discuss our views and recommendations in more detail. In the meantime, if you have any questions about our views or would like to arrange a meeting, please contact our government relations representative in Washington, DC, Peter Barash (202-466-2221, peter@barashassociates.com) or John D. Russell, Director of Government Relations for the American Society of Appraisers (703-733-2103, jrussell@appraiser.org).

Sincerely,

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high-risk transaction, and out-of-market properties. An institution may find it appropriate to employ additional personnel or engage a third party to perform the reviews.

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
United States
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Chris Barnard

16 April 2012

- Docket ID OCC-2011-0028
- Proposed Guidance on Leveraged Lending

Dear Sir.

Thank you for giving us the opportunity to comment on your proposed joint guidance with request for public comment: Proposed Guidance on Leveraged Lending.

The OCC, Board, and the FDIC (the Agencies) request comment on proposed guidance on leveraged lending. The proposed guidance outlines high-level principles related to safe and sound leveraged lending activities, which include: underwriting considerations; assessing and documenting enterprise value; risk management expectations for credits awaiting distribution; stress testing expectations and portfolio management; and risk management expectations. This proposed guidance would apply to all Federal Reserve-supervised, FDIC-supervised, and OCC-supervised financial institutions substantively engaged in leveraged lending activities. The number of community banking organizations with substantial exposure to leveraged lending is very small; therefore the Agencies generally expect that community banking organizations largely would be unaffected by this guidance.

I agree that the proposed guidance is an improvement on your 2001 Guidance, and which describes "expectations for the sound risk management of leveraged finance activities". However, very much of the proposed guidance reads like a simple (and by definition non-exhaustive) list of points that should be considered in order to meet these expectations, rather than true guidance. I would recommend that you should provide some more robust rules, guidance and definitions, in order to strengthen the risk management of leveraged lending, and to promote greater consistency in risk management frameworks, whilst retaining the basic principles-based nature of the proposed guidance. I will comment on some points that could be improved in order to expedite this.

Definition of leveraged finance

The 2001 Guidance states that: "The loan policy should specifically address the institutions' leveraged lending activities by including: A definition of leveraged lending". The proposed guidance expands on this by stating that: "Institutions' policies should include criteria to define leveraged finance. Numerous definitions of leveraged finance exist throughout the financial services industry and commonly contain some combination of the following:

- Proceeds are used for buyouts, acquisitions, or capital distributions.
- Transactions where the borrower's Total Debt/EBITDA (earnings before interest, taxes, depreciation, and amortization) or Senior Debt/EBITDA exceed 4.0X EBITDA or 3.0X EBITDA, respectively, or other defined levels appropriate to the industry or sector.
- Borrower that is recognized in the debt markets as a highly leveraged firm, which is characterized by a high debt-to-net-worth ratio.
- Transactions where the borrower's post-financing leverage, when measured by its leverage ratios, debt-to-assets, debt-to-net-worth, debt-to-cash flow, or other similar standards common to particular industries or sectors, significantly exceeds industry norms or historical levels."

The proposed guidance is not complete or objective enough in order to provide a robust definition of leveraged finance as this will depend on:

- The risk tolerance of the institution;
- Markets' views, which tend to be cyclical;
- Markets' views, which tend to be irrational, in particular during crises.

I would recommend that you propose some fixed ratios, quantities or percentiles, which will provide a more objective metric to quantify leveraged finance. This would at least provide a robust framework for defining leveraged finance, compared to the subjective and circular guidance that you have proposed. This is an important point, as the definition of leveraged finance will affect the quality of the risk management framework adopted by institutions.

Stress testing

Stress testing is mentioned several times in the proposed guidance. Naturally stress testing should allow for shocks and variations along the following lines:

1) changing individual assumptions and parameters (sensitivity testing);
2) changing several assumptions and parameters at the same time, where the assumptions and parameters could reasonably be expected to change together (scenario testing);
3) changing the dependencies assumed between assumptions and parameters.

The importance of point 3 above is often underestimated. I would strongly recommend that you specifically emphasise the importance of considering dependencies and correlations under stress testing, particularly as typically observed and expected dependencies may not apply in the tail conditions and events that underlie many stress conditions and scenarios.

Reputational risk

The proposed guidance contains a new section on reputational risk, which is very valuable. Reputational risk is often overlooked as it is quite difficult to measure and quantify before the event. However, it is important that reputational risk should be considered as part of any risk management framework. I would strongly recommend here that you should expand its scope to specifically include both reputational risk and misselling risk, as one risk often precedes and promotes the other.

Yours faithfully

C.R.B.

Chris Barnard

From:	Daniel.McCready@cit.com
To:	Regs.Comments
Cc:	Robert.Rowe@cit.com; Mark.Cross@cit.com; Lon.Goldstein@cit.com; Karl.Haddeland@cit.com
Subject:	CIT comments on Proposed Leveraged Lending Guidance - Docket Number OCC-2011-0028
Date:	Friday, June 08, 2012 4:34:57 PM
Attachments:	SCNF-ADMIN-12060816160.pdf

Attached please find a letter from Rob Rowe, Chief Credit Officer of CIT, with CIT comments on the Proposed Leveraged Lending Guidelines.

Thank you,

Dan McCready
Chief Credit Officer
Corporate Finance
CIT Group Inc.
11 West 42nd Street, 13th Floor
New York, New York 10036
dan.mccready@cit.com
212.771.9486

Securities and investment banking services offered through CIT Capital Securities LLC, an affiliate of CIT.

---

11 West 42nd Street
New York, NY 10036

June 8, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal EES
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

Office of the Comptroller of the Currency
250 E Street, S.W.
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Washington, DC 20219

Re: Leveraged Lending Guidance; Federal Reserve Docket No. OP-1439; OCC Docket No. OCC-2011-0028

Dear Sir or Madam:

CIT Group Inc. (CIT) appreciates the opportunity to comment on the leveraged lending guidance jointly proposed by your agencies. We fully support the purpose of this guidance. However, as discussed further below, we recommend two modifications to the guidance. One modification relates to the proposed standard for repayment timing by a borrower. The other relates to the proposed definition of leveraged lending.

CIT provides leveraged lending to small and middle market companies.

CIT is a bank holding company that provides commercial financing and leasing products and services to small and middle market businesses across a wide variety of industries either directly or through one of our subsidiaries, which include a Utah State bank. Given the unique financing needs of smaller businesses, we often engage in complex financing transactions, including leveraged lending activities, such as asset based senior debt structures, cash flow financing, and project finance.

CIT supports the issuance of a guidance rather than a regulation.

CIT fully supports the intent of the proposed guidance. We agree that leveraged lending should be conducted within a risk management framework that includes sound underwriting, valuation, and other standards.

We also strongly support the issuance of a guidance on these matters as opposed to a regulation. Regulations, by their very nature, are fixed rules that may not easily accommodate changing market conditions. Leveraged lending transactions, in contrast, are constantly evolving with market developments and the financing needs of companies. A guidance provides lenders and examiners with the needed flexibility to adjust to such changes.

We recommend that the repayment standard for borrowers be 50% of senior secured debt over a five-to-seven year period rather than 100% of senior secured debt.

The guidance states that "base case cash-flow projections should show the [borrower's] ability over a five-to-seven year period to fully amortize senior secured debt or repay at least 50 percent of total debt." Based upon our experience, we believe that this standard is overly conservative. Fully amortizing senior debt over a minimum five-to-seven year period implies 20% to 15% amortization per year, which is more than is necessary to demonstrate fixed charge coverage flexibility in a reasonable downside scenario, and is well in excess of market norms.

We also believe that the minimum amortization standard should be tied to senior debt rather than total debt. A total debt standard would include junior debt and junior debt seldom amortizes, is junior to senior debt in a troubled situation, and often can have interest blocked. Additionally, senior debt is usually larger than junior debt in the capital structure.

Given these concerns, we recommend that the repayment standard for borrowers be set at 50% of senior secured debt over a five-to-seven year period rather than 100% of senior secured debt. This standard would require a borrower to demonstrate an ability to repay 7-1/2% to 10% of senior debt per year. It also allows the borrower sufficient ability to handle swings in economic conditions and is still generally higher than market amortization schedules. Maintaining sufficient fixed charges flexibility in transactions is prudent, but tightening amortization guidelines too much can impact lending volume and therefore availability of capital to businesses.

Alternatively, the standard could be tied to a definition of "sustainable debt" that would distinguish between companies based upon asset levels. Under this alternative, a borrower, as a general rule, would be expected to reduce total debt to a "sustainable debt" level over a five to seven year period with seven years the standard for more established and stable companies and five years for start-up and cyclical companies. For companies with significant assets, "sustainable debt" would be defined as margined current assets plus tangible book value of fixed assets required to run the company.

We recommend that the definition of leveraged lending recognize loan facilities where the collateral value is largely reliant on enterprise value.

The guidance would require each institution to define leveraged finance in a manner that clearly describes the purposes and financial characteristics of the transaction and that includes the institution's exposure to leveraged finance activities. The guidance also lists common characteristics of leveraged finance, such as purpose of proceeds, leverage level and industry norms. While these characteristics are only illustrative, they fail to address loan product type (e.g., cash flow versus asset based lending). Nor do they address the wide range of loss given default (LGD) among various products. These omissions could be interpreted to discourage or penalize the use of asset based lending solutions, if such solutions were to be included within Leveraged Lending.

Such a result would not only disadvantage lenders, such as CIT, which specialize in asset based lending to small and middle market companies, but also would be inconsistent with the intent of the guidance. Asset based lending (ABL) is a safer product than leveraged cash flow lending. Historical LGD shows that losses are lower under ABL structures than cash flow structures.

The Underwriting Standards section of the Proposed Guidance does note that the underwriting standards are not "meant to discourage well-structured standalone asset-based credit facilities to borrowers with strong lender monitoring and controls, for which banks should consider separate underwriting and risk rating guidance." This concept should be reinforced by inclusion of a loan product type, such as cash flow, as an appropriate characteristic in the definition of leveraged lending. Therefore, we recommend that the list of common characteristics of leveraged lending include the following additional statement: "Loan facilities that are secured, but the collateral value is largely reliant upon enterprise value, i.e. a cash flow loan, versus a loan backed by asset values."

In summary, CIT supports the issuance of this guidance, but recommends a modification related to the standard for borrower repayment timing and a modification related to the definition of leverage lending. If you have any questions about this comment or seek any additional information regarding CIT and its leveraged lending activities, please contact me at 212.771.9531 or Dan McCready at 212.771.9486.

Sincerely,

Robert C Rowe

Robert C. Rowe

May 8, 2012

BY ELECTRONIC SUBMISSION

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219

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 Gentleman,

The Loan Syndications and Trading Association ("LSTA") and the American Bankers Association ("ABA") appreciate the opportunity to provide comments to the Agencies concerning the Proposed Guidance on Leveraged Lending ("Proposed Guidance"). The Agencies published the Proposed Guidance in the Federal Register on March 30, 2012 and sought comments by June 8, 2012.[1] We write to request that the Agencies allow an additional sixty (60) days to submit such comments.

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1 Proposed Guidance on Leveraged Lending, 77 Fed. Reg. 19417 (proposed Mar. 30, 2012).

We request this extension for the following reasons:

First, additional time is needed to permit the LSTA and the ABA to compile the views of its members and consolidate and present this information for the Agencies' consideration. The LSTA and ABA believe an extension will allow time to better understand the complex reporting and other requirements outlined in the Proposed Guidance and prepare comprehensive and thoughtful comments. We believe these comments will better assist the Agencies in making decisions on issues with significant implications for its regulated institutions engaged in leveraged lending activities.

Second, many of our members are also currently working on submitting comments on the Federal Deposit Insurance Corporation's proposed rule regarding assessments for large and highly complex insured depository institutions ("Proposed Rule"). This Proposed Rule would revise the definition of certain higher-risks assets, specifically leveraged loans, used in calculating deposit insurance assessments for large institutions. Comments on this notice are due on May 29, 2012, just about one week before comments on the Proposed Guidance. The Proposed Rule and Proposed Guidance were released at approximately the same time and require input from many of the same individuals at the institutions. An additional sixty days would give our members a chance to provide detailed comments on both of these important proposals.
The LSTA and ABA are working diligently to arrange meetings of its members, compile the necessary information, and closely consider the Proposed Guidance. We appreciate your consideration of this request and look forward to your response.

If you have any questions, please do not hesitate to contact Elliot Ganz, General Counsel (eganz@lsta.org; (212) 880-3003), Meredith Coffey, Executive Vice President for Research and Analysis (mcoffey@lsta.org; (212) 880 3019), Denyette DePierro, Senior Counsel, Office of Regulatory Policy (ddepierr@aba.com; (202) 663 5333) or Robert Strand, Senior Economist, Office of the Chief Economist (Rstrand@aba.com; (202) 663-5350).

Sincerely,

THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION

R Bram Smith

R. Bram Smith
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AMERICAN BANKERS ASSOCIATION

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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

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,

R. Bram Smith
Executive Director
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bsmith@lsta.org

June 8, 2012

BY ELECTRONIC SUBMISSION

Office of the Comptroller of the Currency
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Washington, DC 20219

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

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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.

* * * *

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,

THE LOAN SYNDICATIONS AND TRADING ASSOCIATION

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August 21, 2012

BY ELECTRONIC SUBMISSION

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Executive Secretary
Attn: Comments/Legal ESS
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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] thought it would be helpful to expand upon the discussion of the "fallen angel" issue set forth in our comment letter dated June 8, 2012, concerning the Proposed Guidance published in the *Federal Register* on March 30, 2012 by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit

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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.

Insurance Corporation (collectively, the "***Agencies***").[3] We seek to further clarify our position regarding the definition of "leveraged finance." As we previously stated, the Proposed Guidance should not encourage or require that the term "leveraged finance" be applied to "fallen angels" and other loans not designated as leveraged at the time of origination. Such definition should include only those loans that contain the unique structural characteristics of leveraged loans at their inception, and should not sweep up loans made to borrowers that over time diminish in credit quality.

I. If the definition of "leveraged finance" is not limited to loans that are identified as leveraged at their inception, monitoring leveraged loans will become more difficult, as will setting limits and determining loan origination criteria.

Inclusion of "fallen angels" in a bank's leveraged loan portfolio will not enhance a bank's or its examiners' ability to ascertain the risk of the portfolio. Rather, putting "fallen angels" into the leveraged loan category is likely to impair the ability to make risk assessments on outstanding loans and will also make future loan origination more difficult and potentially more risky.

The arbitrary inclusion in the leveraged loan portfolio of loans that do not share the representative characteristics of loans originated as leveraged will add "static" to the data that banks collect on leveraged loans. This contamination of the data pool will make it difficult for banks to assess the actual performance of loans that were originated as leveraged loans. A bank's leveraged loan portfolio will expand and contract over time, as loans fall into and out of the reporting category due to fluctuations in credit quality.

According to Moody's Investors Service, the 1920-2011 average one-year corporate migration rate from Baa to non-investment grade was 6.12%. Similarly, as an example, a bank representative of those we have spoken with reviewed its entire portfolio over a recent two-year period and determined that 31% of its portfolio was rated non-investment grade at inception. Two years later, 42% of the portfolio was rated non-investment grade (or unrated/ had exited). In the BBB/BBB- category, 28% of the borrowers migrated to non-investment grade (or unrated/had exited). Conversely, 22% of the issuers rated the equivalent of BB/BB+ at the beginning of the period were rated investment grade two years later. While these examples relate specifically to movement in and out of investment grade, they illustrate that there can be material ratings migration within a portfolio.

With loans entering and exiting the leveraged loan portfolio, cohort analysis of the portfolio will be functionally impossible, given the constantly changing set of loans to be

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

included in the pool.[4] On the other hand, the traditional approach of categorizing loans only at inception appropriately isolates and identifies a specific type of lending activity and its risks.

The inclusion in the leveraged loan portfolio of a borrower whose financial performance and prospects have deteriorated and which now meets all the criteria for a leveraged loan will further distort the leveraged loan pool data due to the inclusion of borrowers that have relatively short-term performance issues which are not reflective of overall credit quality, such as borrowers that have suffered an unusual write-down or loss, are in a cyclical business or have been subject to unforeseen short term disruptions.[5] The Proposed Guidance would, however, require that such a loan be included in a bank's leveraged loan portfolio, at least until such borrower's financial results improve. The fundamentally inaccurate data generated will in turn impair the ability of banks to set credit policy and limits going forward, as well as the ability to properly stress test new loans.

Because of the uncertainty of the universe of loans to be included in the leveraged loan category and the inability to predict which borrowers may become "fallen angels", risk managers might well be forced to raise aggregate credit limits for their leveraged loan portfolio, in order to account for both leveraged loans at inception and for a future – but unknowable – number of "fallen angels" that have migrated into the leveraged loan category. In addition, including "fallen angels" in the leveraged loan portfolio will likely skew the average performance of the portfolio as a whole (in light of the fact that "fallen angels" might well have lower leverage ratios than most leveraged loans), giving the appearance of overall better performance of the leveraged loan portfolio. Although it is difficult to predict what unintended consequences may result from putting "fallen angels" into the leveraged loan portfolio, the artificially high credit limits and skewed performance assessments may result in increased appetites for credit risk, with banks utilizing increased credit limits to originate more leveraged loans. Alternatively, if banks do not adequately allow room in the limits for "fallen angels", the opposite effect could result, with banks providing less liquidity to credit-worthy leveraged loan borrowers.

Clearly if the foregoing occurs it will weaken, rather than enhance, the management of leveraged finance risk and will have the consequence of undermining the utility of the proposed requirements for information collection and reporting.

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4 Cohort analysis depends on a defined set of study participants. Consider a long-term medical study of smokers. If individuals who are non-smokers at the start of the study but later take up smoking are added to the pool of subjects during the course of the study, the data collected during the study will not likely be helpful to any large degree.

5 For example, Teck, a Canadian diversified mining company, was rated investment grade in mid-2008 when it acquired Fording Canadian Coal in all all-debt deal. After the acquisition, Teck's ratings were downgraded in late 2008-2009 due to poor conditions in the company's core markets. Teck regained its investment grade ratings at the beginning of 2010, following the company's deleveraging post-acquisition and improving industry fundamentals. However, adding Teck's debt to the bank's leveraged loan portfolio and then removing it following the company's recovery would have distorted reporting of the leveraged loan portfolio.

II. Banks already monitor loans not designated as leveraged at the time of origination for problem risk assets and risk migration.

To the extent the proposed expansion of "leveraged finance" criteria to include "fallen angels" is due to a concern that non-leveraged loans are not properly monitored, we believe that this concern is adequately addressed through each bank's existing credit standards and risk monitoring. Loans not designated as leveraged at the time of origination are monitored for problem risk assets and risk migration according to bank policies and procedures (including via, among other things, summary risk ratings, risk migration reporting, asset quality forecasting and stress testing). Troubled non-leveraged loans are reported to the OCC not only on a continual basis but also in response to the Agencies' information requests.

The LSTA and ABA believe that the monitoring policies and procedures for non-leveraged loans have worked well to ensure appropriate oversight of such loans. Having these loans transition from standard monitoring to leveraged loan monitoring is more likely to complicate and confuse than assist lenders in the management of their loans.

III. Banks will incur extensive costs to generate the information required by an expanded definition of "leveraged finance," without any benefit to the banks or examiners.

In order to comply with the "fallen angel" provisions outlined in the Proposed Guidance, banks will need to incur extensive costs and devote considerable resources. Management information systems ("***MIS***") would have to be significantly overhauled to include an additional tracking and reporting process to monitor loans that could potentially become leveraged loans. The Proposed Guidance would require tracking of essentially every loan related in whole or in part to an acquisition or distribution, in case the borrower's debt to EBITDA ratio exceeds set thresholds in the future. Doing so would necessitate that banks recode their MIS, a process that is both difficult and costly, requiring a massive number of hours of work at each bank. Additionally, the complexity of the analysis will result in a slower, more expensive process that will not provide the "real time" analysis the Proposed Guidance is intended to promote and may be more prone to error. As discussed above, not only will no benefit result from this change in reporting, but the change could result in skewed data and potentially more risky behavior on the part of banks.

* * * *

For the foregoing reasons, the LSTA and ABA respectfully request that the Agencies revise the scope of the Proposed Guidance to exclude from the definition of "leveraged finance" those credits that were not designated as leveraged at the time of origination. 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. In addition, the proposed change in the definition could have unintended consequences with respect to the amount of new leveraged loans originated.

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,

THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION

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From:	Heard, Marilyn
To:	Regs.Comments
Subject:	OCC 2011-0028 - Proposed Leveraged Finance Guidance
Date:	Monday, June 04, 2012 11:30:56 AM

Regarding OCC 2011-0028 – Proposed Leveraged Lending Guidance:

1. To help provide consistency, the guidance should define the term "covenant lite." An appropriate definition would include transactions without financial maintenance covenants, transactions with incurrence covenants, and transactions that lack meaningful, financial covenants such as those with excessive headroom (or cushions) greater than 20%.
2. To help bring discipline to underwriters of leveraged transactions, the underwriting fee should be amortized over the term/life of the transaction instead of recognizing fees once the transaction has been successfully underwritten (or underwriters sell their positions in the marketplace).

Lyn Heard
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From:	Steve Baca
To:	Regs.Comments; "regs.comments@federalreserve.gov"; "Comments@FDIC.gov"
Subject:	Proposed Leveraged Lending Guidance - Docket Nos. OCC-2011-0028 and OP-1439
Date:	Friday, June 08, 2012 4:57:34 PM
Attachments:	final leveraged finance june 2012.pdf

Please accept the attached comment letter from Pacific Coast Bankers' Bancshares in regard to the Proposed Guidance on Leveraged Lending.

Thank you,
Steve

Steve Baca
SVP & Chief Risk Officer
Pacific Coast Bankers' Bancshares
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PACIFIC COAST BANKERS' BANCSHARES

June 8, 2012

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Ms. Jennifer J. Johnson
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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
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BY ELECTRONIC SUBMISSION

RE: Proposed Leveraged Lending Guidance (Docket Nos. OCC-2011-0028 and OP-1439)

Overview

Pacific Coast Bankers' Bancshares[1] ("Bancshares") appreciates the opportunity to provide comments to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively known as the "Agencies") concerning the Proposed Guidance on Leveraged Lending ("Proposed Guidance").

Bancshares agrees with the Agencies' comments that, "Leveraged finance is an important type of financing for the economy."[2] Today, the leveraged finance market is comprised of firms that originate and syndicate transactions (primarily large commercial banks) and investors (large commercial banks, insurance companies, etc.). However, even community banks[3] have booked transactions originated and distributed through this channel.

During the years leading up to the financial crisis, community banks generally became over-reliant on commercial real estate and construction lending activities as a primary driver to growth in their loan portfolios. This over-reliance caused various concentration issues within these banks' loan portfolios. Since that time, community banks have continued to reduce their holdings in these loan types while at the same time struggling to book loans with the same or better quality. Leveraged lending transactions can be a suitable alternative to commercial real estate and construction loans by creating needed earning assets while at the same time creating better diversification within their loan portfolios.

[1] Bancshares, through its wholly owned subsidiaries, Pacific Coast Bankers' Bank ("PCBB") and PCBB Capital Markets, LLC, provides correspondent banking services to over 500 community banks and savings associations (together "community banks") throughout the United States. Through its subsidiaries, Bancshares offers a range of services that assist community banks in managing risk and improving performance; one such service that Banschares offers to its community bank clients affords them the opportunity to purchase loan transactions originated in the syndicated loan market.

[2] Joint Press Release, March 26, 2012.

[3] Bank with assets up to $2 billion are the focus of this comment letter.

Bancshares also agrees with the Agencies that sound risk management practices are critical to undertaking any risk. However, Bancshares respectfully requests that the Agencies consider the following comments prior to finalizing the Proposed Guidance.

A percentage of capital should be used in establishing whether a bank has significant leveraged finance activities.

The Proposed Guidance emphasizes the need for a robust risk management framework if a bank has "significant" leveraged lending activities. Failure to have such a risk management framework in place could result in severe regulatory scrutiny. However, the term "significant" is not clarified. Without clarification, Bancshares is concerned that the term would be inconsistently applied among different regulators conducting examinations at different community banks across the U.S. Using a percentage of capital as a way of clarifying the word "significant" would simplify the meaning of the Proposed Guidance for regulators applying it and for bankers understanding whether it applies to their institution. Bancshares believes that community banks that prudently lend up to 100% of their capital (Tier 1 + ALLL) to leveraged borrowers should be deemed to be engaged in insignificant leveraged finance activities.

An exemption for community banks that have an insignificant amount of leveraged financing transactions should be created.

As mentioned in the Proposed Guidance, there are a limited number of community and smaller institutions that have leveraged lending activities. However, the Proposed Guidance would require any community bank that has even one leveraged transaction to discuss the "implementation of cost-effective controls" with their primary regulator. Bancshares acknowledges that it is critical for all community banks to maintain an open dialogue with their primary regulator on topics pertaining to proper controls. However, Bancshares' has concern over the unintended consequences that may arise from this portion of the Proposed Guidance – namely, that when individually approached by community banks that have insignificant leveraged lending activities, regulators may, by default, require these community banks to implement the robust risk management framework outlined on the Proposed Guidance.

In summary, Bancshares believes a robust risk management framework is important for banks that have significant leveraged lending activities. However, if the term "significant" is not clarified, community banks that have insignificant leveraged finance activities may still be required to follow the same risk management framework required for banks that have much higher levels of leveraged financing. If a de facto, one-size-fits-all risk management framework is created through the Proposed Guidance, some community banks could be deprived from booking earning assets at a time when they are needed most.

Regards,

Steven A. Brown
President & Chief Executive Officer
Pacific Coast Bankers' Bancshares

From:	Proctor, Samuel E.
To:	Regs.Comments
Subject:	Docket Number OCC-2011-0028
Date:	Friday, June 08, 2012 11:53:45 AM
Attachments:	PEGCC Leveraged Lending Comment Letter to OCC.pdf

To Whom it May Concern,

The Private Equity Growth Capital Council (the "PEGCC") submits the attached comment letter in response to the Proposed Guidance on Leveraged Lending.

Best Regards,

Steve Judge
President and CEO
Private Equity Growth Capital Council
950 F Street, NW
Suite 550
Washington, DC 20004

PRIVATE EQUITY
GROWTH CAPITAL
COUNCIL

SUBMITTED ELECTRONICALLY

June 8, 2012

Office of the Comptroller of the Currency
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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
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Washington, DC 20551

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

Re: Proposed Guidance on Leveraged Lending
OCC Docket Number 2011-0028

Dear Sirs and Madams:

The Private Equity Growth Capital Council (the "PEGCC") appreciates the opportunity to comment on the Proposed Guidance on Leveraged Lending (the "Proposed Guidance") issued by the above-listed federal banking agencies (the "Agencies").[1] The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007, and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The PEGCC members are 36 of the world's leading private

1 77 Fed. Reg. 19,417 (Mar. 30, 2012).

equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.[2]

The PEGCC agrees with the Agencies that leveraged finance activities, like other lending activities, benefit from sound risk-management practices, including well-documented credit decisions and active monitoring of borrower performance. The PEGCC also believes that lending institutions' leveraged finance risk-management practices must be permitted to vary in order to reflect individual institutions' leveraged portfolios, assets, earnings, liquidity, capital and experiences. To this end, the PEGCC is concerned that certain aspects of the Proposed Guidance are overly prescriptive and, contrary to the Agencies' assertion, inconsistent with industry norms and practices.

The PEGCC believes that, as discussed further below, the Agencies should avoid deploying artificial "bright-line" tests in any Final Guidance because such tests may not allow individual institutions to vary their approaches to reflect the facts and circumstances of a particular transaction or to accommodate differences among borrowers and industry sectors. Moreover, the PEGCC is concerned that, particularly over time, rigid tests may prove unworkable and counter-productive, as lenders rely on artificially established ratios and standards in lieu of the detailed credit analysis and careful risk-based judgments that the Agencies wish to promote.

For these reasons, the PEGCC strongly believes that industry participants must be permitted to adjust their leveraged lending practices to reflect borrower creditworthiness, market conditions and transaction details. Importantly, allowing such variations would not hinder the Agencies' ability to curb unsafe and unsound practices at particular institutions, which the Agencies have ample authority to address through the supervision and examinations process.

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[2] The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; CCMP Capital Advisors, LLC; Crestview Partners; The Edgewater Funds; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; TPG Capital (formerly Texas Pacific Group); Vector Capital; Vestar Capital Partners; and Welsh, Carson, Anderson & Stowe.

Definition of Leveraged Finance. The Proposed Guidance would require institutions involved in leveraged lending to adopt a definition of leveraged finance. The Agencies acknowledge that "numerous" definitions exist in the financial services industry. The Agencies offer that lending institutions may rely on a definition that includes some combination of four factors. One of those factors would rely on a 4X debt/EBITDA or 3X senior debt/EBDITA ratio, but the Agencies also suggest that "other defined levels appropriate to the industry or sector" may be used as appropriate. The Agencies do not identify the source for their 4X and 3X ratios.

The PEGCC believes that relying on any pre-defined debt/EBITDA ratios is inappropriate. Such an approach would not reflect variations in borrower risk profiles that are influenced by several variables, including variations in capital structures, volatility of cash flows and varied competitive dynamics across sectors and industries. Pre-established ratios therefore would lead to differently situated borrowers – in vastly different industries – being subject to the same risk-management approach, which seems a counter-productive use of lender resources.

For this reason, the PEGCC believes that the Agencies should not require institutions to incorporate a pre-established debt-to-EBITDA ratio in defining leveraged finance. The Agencies should instead allow institutions, as part of their risk-management frameworks, to establish definitions of leveraged lending that are appropriate for the industries, sectors and borrowers to which they lend.

Underwriting Standards. The Proposed Guidance would call on lending institutions to establish clear, written underwriting standards. The Agencies further specify that, at a minimum, underwriting standards should consider a "borrower's capacity to repay and its ability to de-lever to a sustainable level over a reasonable period."

The PEGCC concurs that borrower repayment and de-leveraging abilities are appropriate for consideration in underwriting standards, but the PEGCC disagrees with the Agencies' follow-on statement that, "[a]s a general guide, base cash-flow projections should show the ability over a five-to-seven year period to fully amortize senior secured debt or repay at least 50 percent of total debt." The PEGCC strongly believes that such a bright-line test, relying on specific percentages as a target for a set period of years, is inappropriate. Lenders, instead, should be encouraged to look to a variety of factors, including industry norms, that may affect a borrower's ability to repay its obligations.

Covenants. In the Proposed Guidance, the Agencies discuss the need for credit agreements to include covenant protections. One particular covenant cited by the Proposed Guidance is that an entity's leverage level after planned asset sales not exceed 6X total debt/EBITDA, which the Agencies suggest is an appropriate level for "most industries."

Credit agreement covenants are highly negotiated and reflect considered judgments between sophisticated parties as to the allocation of the specific risks arising from the particular transaction. Moreover, an over-reliance on covenants can be highly problematic, as the result may be technical breaches and "foot faults" that create difficulties for both the lender(s) and borrower. Consequently, in Final Guidance, the Agencies should ensure that lending institutions have the discretion to rely on covenants that are appropriate and reflect the risks present in particular transactions.

The PEGCC also believes that the use of pre-set debt-to-EBITDA ratios is inappropriate in this context. Referencing a specific debt-to-EBITDA ratio does not account for variations across deals and markets. The Agencies seem to acknowledge this limitation, suggesting that the Proposed Guidance's specific ratio is suitable for "most industries." That standard is both overly vague and overly broad – which industries fall within the "most" and which fall outside? Such vague pronouncements by the Agencies may result in lenders relying on a 6X debt/EBITDA standard across-the-board, even when different ratios are necessary and warranted and even though the Agencies offer no rationale for the 6X standard. The PEGCC urges the Agencies to remove from Final Guidance any reference to a pre-set ratio of debt/EBITDA.

Deal Sponsors. The Proposed Guidance would require lending institutions to formulate guidelines that evaluate the qualifications of financial sponsors and implement a process to monitor performance. The Agencies go on to note that lenders "may consider support from a sponsor in assigning an internal risk rating." The Agencies state that evaluation of a sponsor's financial support should include a number of specific items.

The PEGCC concurs that lenders should be permitted – but not required – to consider sponsor support. The PEGCC does not believe that the Agencies' Proposed Guidance suggests differently, but the PEGCC recommends that the Agencies clarify this point in Final Guidance.

* * *

In sum, the PEGCC supports sound risk-management practices among leveraged finance lenders, but it strongly believes that the Agencies should ensure that lending firms are able to adopt sound standards that reflect individual risk-based analyses. To this end, the PEGCC asks the Agencies to ensure that the Final Guidance does not include artificial, bright-line tests that may discourage individualized judgments and careful credit analysis.

The PEGCC appreciates the Agencies' consideration of this letter and is available to discuss any questions that the Agencies may have.

Respectfully submitted,

Steve Judge

Steve Judge
President and CEO
Private Equity Growth Capital Council

From:	Byron Dorgan
To:	Regs.Comments; regs.comments@federalreserve.gov; comments@fdic.gov
Subject:	Proposed Leveraged Lending Guidance; Docket ID OCC-2011-0028; Docket No. OP - 1439
Date:	Friday, June 08, 2012 12:11:35 PM
Attachments:	0222_001.pdf

I am submitting the attached letter containing my comments on the proposed rulemaking relating to highly leveraged lending. Thank you for the opportunity to share my thoughts on this matter.

Byron L. Dorgan
U.S. Senator (ret.)

BYRON L. DORGAN
UNITED STATES SENATOR (Ret.)
(1992 – 2011)

June 8, 2012

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Jennifer J. Johnson, Secretary
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Robert E. Feldman, Executive Secretary
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Proposed Leveraged Lending Guidance;
Docket No. OCC-2011-0028; Federal Reserve Docket No. OP–1439

Dear Ladies and Gentlemen,

I appreciate the opportunity to comment on the Agencies' Proposed Guidance on Leveraged Lending, published in the Federal Register on March 30, 2012. [1]

My concern about the issues raised in your proposed rulemaking dates back to the mid 1990's when I authored an article that was used as the cover story in the Washington Monthly Magazine titled "Very Risky Business."

The article expressed my concern then about banks whose deposits were insured by the American taxpayers trading in derivatives on their own proprietary accounts. Over the years, my concerns about the amount of risk these banks were taking proved to be well founded. The bank bailouts that were required beginning in late 2008 and 2009 were evidence of the substantial danger to the taxpayers when banks engage in activities that, in other circumstances, would be called "gambling."

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

Since writing that article, I have published a book titled "Reckless" on the general subject and have been engaged both in the U.S. Senate and outside of it, in support of effective regulatory oversight of this type of banking practice.

Although the article I wrote in the mid 1990's focused on the banks' proprietary trading in derivatives, the very same issues now present themselves in the concerns surrounding highly leveraged lending. These risky loans can express the same jeopardy for the taxpayers and the same concerns about safety and soundness. That is the reason I believe the action proposed by the Agencies is both necessary and prudent and why I welcomed the opportunity to submit supporting comments and to suggest an additional safeguard to help manage such risks.

Large Banks and Moral Hazard

Large banks occupy a unique position among market participants due to their size and systemic importance and the competitive position they enjoy in the lending markets. As the events of recent years have reminded us, banks do not internalize all risks they take. Rather, they hold deposits that are backed by federal insurance, they have special access to loans on advantageous terms from the Federal Reserve, and they receive extraordinary government assistance (*e.g.*, TARP funds) to ensure their viability at times of intense stress. Leveraged loans—particularly the "covenant-lite" variety that has become more prevalent—entail risk that removes them from the realm of traditional banking. In light of the implicit and explicit taxpayer support (and the potential for "moral hazard" that this public support implies) and the high-risk nature of leveraged lending, the Agencies have a responsibility to ensure that these risks are prudently managed.

The Nature of Leveraged Lending

Leveraged lending may carry considerable risk for banks, as regulators have acknowledged in a variety of contexts in recent years as such lending activity has increased. For example, the FDIC's recently proposed guidelines for large bank assessments would employ specific guidelines to identify certain leveraged loans as "higher-risk assets" and therefore subject to inclusion in the formula for calculating assessments due to the FDIC.[2]

Indeed, leveraged loans may involve proprietary risk levels comparable to those the Volcker Rule is intended to address. As commentators have pointed out, bank activity need not involve trading in order to impose substantial proprietary risk.[3] "Covenant-lite" loans lack many of the typical covenants intended to protect the lender against certain risks. Leveraged lending

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2 Assessments, Large Bank Pricing, 77 Fed. Reg. 18,109 (Mar. 27, 2012). *See also, e.g., See* Office of the Comptroller of the Currency, SURVEY OF CREDIT UNDERWRITING PRACTICES 2011, at 8, *available at* http://www.occ.gov/publications/publications-by-type/survey-credit-underwriting-practices-report/pub-survey-cred-under-2011.pdf (describing increasing risk-taking in leverage lending).

3 Benn Steil, Senior Fellow and Director of International Economics, Beyond the Volcker Rule: A Better Approach to Financial Reform, Council on Foreign Relations, Policy Innovation Memorandum No. 18, available at http://www.cfr.org/financial-crises/beyond-volcker-rule-better-approach-financial-reform/p27894 ("In short, proprietary risk taking is the issue to be concerned with. Proprietary trading may not involve taking much risk, and proprietary risks can be large without much trading.").

involves proprietary risk-taking on a scale that is not traditional—even if lending is a traditional bank activity. Covenant-lite loans to firms with high debt levels are frequently as risky as other proprietary activity.[4]

The Agencies' proposal reflects their recognition that the nature of the risk, rather than the particular label attached to an activity or product, is of key importance.[5] This point also is highlighted by the Volcker Rule's reference to "high-risk assets." In the context of the Volcker Rule, an activity that otherwise is permitted under the rule is prohibited if it involves material exposure of the banking entity to a "high-risk asset." A "high-risk asset" is "an asset or group of related assets that would, if held by a covered banking entity, significantly increase the likelihood that the covered banking entity would incur a substantial financial loss or would fail."[6]

Simply put, leveraged lending carries substantial risk. At a time when legislators' and regulators' attention has focused so keenly on monitoring and mitigating risk at large banks, the Agencies should move forward with their proposed risk management measures for leveraged lending.

<u>The Expansion of Leveraged Lending and Covenant-Lite Loans</u>

Leveraged lending in general, and covenant-lite lending in particular, has expanded in recent years.[7] The OCC has observed that banks are taking increasingly larger risks in connection with leveraged lending, as credit risk increases and banks ease underwriting standards, lower pricing, and demand fewer covenants.[8] The OCC found that pricing is the primary means by which banks ease underwriting standards for commercial products.[9] The risks

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4 *See, e.g.*, Raghuram G. Rajat, FAULT LINES: HOW HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY 173 (2010) (arguing that inherent riskiness is an insufficient basis for banning proprietary trading, though this is commonly presented as the rationale for the Volcker Rule, and stating "In truth, if banks want to take risk, they can simply go further down the spectrum of risk in any of the activities permitted to them. For example, so long as they can lend, they can freely make unsecured, long-term, "covenant-lite" loans to heavily indebted firms.").

5 It is notable, for instance, that the proposal takes a policies-and-procedures approach to risk management and would have banks define "leveraged lending" in the context of their own activities and risk parameters, rather than, for instance, imposing a universal definition or leverage ratio restrictions.

6 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846, 68,950 (Nov. 7, 2011) (§__.8(c)(2) of proposed Volcker Rule).

7 *See, e.g.*, Theresa A. Einhorn, *Annual Review of Developments in Business Financing: Current Trends in the Corporate Credit Markets*, 41 No. 2 THE LAWYER'S BRIEF 2 (May 31, 2011) ("In 2007, $96 billion of covenant-lite loans were issued, mostly to finance private equity buyouts. In contrast, in 2010 only $5 billion were issued. In the first two months of 2011, $17 billion of covenant-lite loans had already been issued."); Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market, and Corporate Governance*, 34 J. CORP. L. 641, 662 (2009) ("Before the subprime loan meltdown in 2007, private equity sponsors saw a substantial rise in "covenant-lite" (or "cov-lite") loans--which, as the name suggests, had substantially fewer covenants than most commercial loans -- jumping from four in 2005 to over 100 in 2007. Market participants attributed a portion of the decline in covenant levels to the increased ability to hedge risk in the credit market and the weakening incentives of banks to screen and monitor borrowers.").

8 *See* Office of the Comptroller of the Currency, SURVEY OF CREDIT UNDERWRITING PRACTICES 2011, at 8, *available at* http://www.occ.gov/publications/publications-by-type/survey-credit-underwriting-practices-report/pub-survey-cred-under-2011.pdf.

9 *See* OCC SURVEY OF CREDIT UNDERWRITING PRACTICES 2011, at 4.

posed by covenant-lite loans may be underestimated in the current markets, magnifying their potentially negative impact.[10]

Large Banks as Lenders

Large banks are different from other lenders because they are backed by federal deposit insurance and because their size and systemic importance gives the government a special interest in preventing their collapse. During and after the recent credit crisis, large banks were bailed out by TARP funds and billions of dollars in emergency loans on advantageous terms.[11] The bailout experience has increased the potential for moral hazard in bank lending. One study about risk-taking by banks found that banks that received TARP funds engaged in riskier lending, although their total lending amounts remained stable.[12] This finding counters arguments that federal funds increase lending and therefore promote broad economic recovery. The market will not naturally account for all risk. To the contrary, regulators need to address risky activities with specificity in order to combat banks' disincentives to account fully for these risks.[13]

Competitive Pressures in Leveraged Lending

According to the OCC's Handbook on Leveraged Lending, corporate borrowers "often require banks to participate in their credit facilities before purchasing other corporate treasury products."[14] As the OCC has observed, competitive pressures are one of the key reasons banks lower their underwriting standards, thereby increasing risk to the banks and hence to taxpayers.[15] The OCC's National Risk Committee ("NRC") will soon release its *Semi-Annual Perspective on Risk* that will describe systemic threats, the data that evidences them, and measures the OCC is

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10 *See, e.g.*, Theresa A. Einhorn, *Annual Review of Developments in Business Financing: Current Trends in the Corporate Credit Markets*, 41 No. 2 THE LAWYER'S BRIEF 2 (May 31, 2011) ("Moody's cautions that covenant-lite structures 'may be laying the groundwork for painful fallout from the next credit downturn.' With covenant-lite terms, companies avoid default for a longer time, which means that by the time a default occurs, the company will be in weaker financial condition.").

11 *See, e.g.*, Bob Ivry, Bradley Keoun and Phil Kuntz, *Secret Fed Loans Gave Banks $13 Billion Undisclosed to Congress*, Bloomberg Markets Magazine (Nov. 27, 2011), available at http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html ("The Fed says it typically makes emergency loans more expensive than those available in the marketplace to discourage banks from abusing the privilege. During the crisis, Fed loans were among the cheapest around, with funding available for as low as 0.01 percent in December 2008, according to data from the central bank and money-market rates tracked by Bloomberg.").

12 *See* San Duchin and Denis Sosyura, *Safer Ratios, Riskier Portfolios: Banks' Response to Government Aid*, dated Sept. 2011, *available at* http://www.fdic.gov/bank/analytical/cfr/2011/sept/BRC_2011_51_Sosyura.pdf.

13 *See* Testimony by David K. Wilson, Deputy Comptroller, Credit and Market Risk, Office of the Comptroller of the Currency, before the Subcomm. On Fin. Institutions and Consumer Protection, Sen. Comm. On Banking, Housing, and Urban Affairs, at 4 (June 15, 2011), *available at* http://www.occ.gov/news-issuances/congressional-testimony/2011/pub-test-2011-72-written.pdf ("[R]egulators need to take steps to restore greater transparency and accountability by all market participants – lenders, borrowers, and investors – to facilitate market discipline on excessive risk taking and dispel reliance on potential or perceived government backstops.").

14 LEVERAGED LENDING, Comptroller's Handbook, Comptroller of the Currency, at 3 (2008), *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/leveragedlending.pdf.

15 OCC SURVEY OF CREDIT UNDERWRITING PRACTICES 2011, at 7 ("When banks were easing standards, increased competition, risk appetite, and market liquidity were the main reasons for easing.").

taking to address them.[16] Martin Pfinsgraff, co-chair of the NRC, recently cited competitive pressures as one of the themes that emerged in the NRC's recent meetings: "Fee income is down as is loan demand, creating competitive pressures to lower underwriting standards, price or both. We are seeing that trend in high yield, cards, and commercial and industrial loans at present."[17]

As might be expected, the OCC has addressed the "slippage" of standards by directing examiners to criticize risky credits they encounter in examinations.[18] Such measures are a sensible starting point for addressing risks as their scope becomes more apparent and problematic. Having identified a risky trend, however, mitigation at the point of examination is inadequate for the longer term. Risk management must be imposed at the time the loan is made. Clear regulatory guidance is needed to promote responsible and effective internal risk management at banks.

Below-Market Loans

As noted above, leveraged lending is one aspect of competitive pressure and bargaining between banks and corporate clients. The anti-tying restriction applicable to banks, which reflects concern about banks' unusual market power, prohibits banks from conditioning the availability or price of a product or service to the customer's purchase of another product or service.[19] Even if practices do not constitute tying, however, the competitive landscape raises concerns about whether banks are using their market power to unfair advantage. To the extent that banks offer loans at below-market rates, measured by price or other terms, their lending practices are anti-competitive, high risk, and proprietary in nature, and must therefore be addressed.

The Financial Accounting Standards Board ("FASB") proposed in 2010 to expand mark-to-market accounting to include loans and other financial instruments historically subject to other accounting methods.[20] The breadth of the FASB proposal elicited many objections, and the FASB eventually backed away from key elements of its initial proposal. As the FASB's

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16 Martin Pfinsgraff, OCC Deputy Comptroller for Credit and Market Risk, Remarks before the Risk Magazine Credit Risk Conference, New York, NY (May 22, 2012), *available at* http://www.occ.treas.gov/news-issuances/speeches/2012/pub-speech-2012-81.pdf.

17 *Id.*

18 *See* Testimony by David K. Wilson, Deputy Comptroller, Credit and Market Risk, Office of the Comptroller of the Currency, before the Subcomm. On Fin. Institutions and Consumer Protection, Sen. Comm. On Banking, Housing, and Urban Affairs (June 15, 2011), *available at* http://www.occ.gov/news-issuances/congressional-testimony/2011/pub-test-2011-72-written.pdf. Wilson told the Subcommittee: " [W]e have admonished national banks not to compromise their underwriting standards due to competitive pressures. Where we see signs of such slippage, we are intervening at an early stage. For example, last June in response to signs of slippage that examiners were seeing in some leveraged loan facilities, we issued guidance to our examiners that reinforced our supervisory expectations for this type of lending and directed them to criticize or classify credits that exhibit minimal repayment capacity, excessive leverage or weak/nonexistent covenants, even when the credits had been recently advanced." *Id.*

19 Bank Holding Company Act Amendments of 1970, § 106.

20 FASB Exposure Draft, Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments (Topic 825) and Hedging Activities (Topic 815), File Reference No. 1810-100 (May 26, 2010) ("Exposure Draft").

deliberations have continued, however, one aspect of the proposal that remains is a concern for off-market transaction prices. The current summary of the FASB's positions states in part, "In certain circumstances, an entity would be required to evaluate whether the consideration given or received at recognition for a financial instrument that is not otherwise required to be initially measured at fair value indicates that an element other than the financial instrument is included in the transaction."[21]

The initial FASB proposal was more specific in how it addressed situations in which transaction price differs significantly from the fair value of a financial instrument, indicating the presence of "other element(s)" in the transaction.[22] The proposal, which aimed to promote transparency in disclosures about financial instruments, would have required a bank to acknowledge and account for a loan's divergence from market terms. Evidence of such difference could be found in, among other things, "[t]he price that a third-party buyer would be willing to pay to acquire a financial asset or to assume a financial liability"—in other words, in the case of leveraged lending, evidence that the loan was made off-market and would trade at a discount to par.

The FASB deliberations are a reminder that certain types of transactions—such as leveraged loans, especially the covenant-lite variety—may not be readily transparent and, in any event, unquestionably involve proprietary risks and incentives that require accountability, management, and mitigation. Particularly where there are safety and soundness concerns, and where risks impact banks' balance sheets and capital (and, therefore, taxpayer funds), adequate risk management controls are essential. A key aspect of effective risk management in this context is a system that allows risk managers to identify the actual substance of the transaction and thus the actual risks involved. In other words, when "relationship lending" occurs, risks

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21 *See* FASB's Accounting for Financial Instruments, Summary of Decisions Reached to Date During Redeliberations, at 2 (dated May 21, 2012), *available at* http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156422130. The "initial measurement principle" is stated in paragraph 12 of the initial proposal. Exposure Draft, at 32-33.

22 Exposure Draft, at 33-34, ¶¶14-17. The proposed guidance called for "reliable evidence" that there is a significant difference between transaction price and fair value. Such evidence may be found in any of the following:

> "a. The terms of a financial instrument, such as upfront and ongoing fees, duration, collateral, and restrictive covenants
> b. Prevailing rates offered to other borrowers or offered by other lenders for similar financial instruments that are not influenced by unstated or stated rights and privileges
> c. Prevailing rates of other financial instruments with the same borrower or lender that are not influenced by unstated or stated rights and privileges
> d. The price that a third-party buyer would be willing to pay to acquire a financial asset or to assume a financial liability
> e. If noncash items are exchanged, the current cash price for the same or similar items exchanged in the transaction."

Exposure Draft, at 67-68. One example given of such a situation is "a credit facility offered at an off-market rate in exchange for goods or services at off-market prices." In this example, the lender would recognize the loan at fair value, and the difference between the transaction price and fair value would be recognized in net income. Exposure Draft, at 68.

cannot be adequately identified and managed unless the complete economic substance of the transaction is transparent, including, for example, any discounts and incentives.

Good Faith Par Standard

At base, though, the most effective risk mitigant as it pertains to leveraged lending is to prohibit banks from making off-market loans. While banks should, as the FASB has recommended, account for the economic substance and inherent risk of their lending transactions, banks at the outset should not be permitted to take undue risks with depositor funds or compromise safety and soundness by engaging in excessively risky long-term lending activity for the sake of near-term ancillary fee income. In the case of leveraged lending, a bank should not make a leveraged loan unless there is a good-faith belief that the loan is made at market-clearing terms and will trade at par immediately after origination (or would trade at par, even if immediate sale is not intended). Imposing this simple standard would reinforce accountability and serve as an important gauge of whether the risk involved is reasonable: the absence of such a good-faith belief indicates that the loan is being made at below-market terms and, as such, carries undue risk, creates proprietary exposure, and constitutes anti-competitive behavior.

Conclusion

Regulators have been following the rise in leveraged lending for several years and have recognized the risks involved. I applaud the Agencies' efforts in identifying and analyzing the various dimensions of these risks. As we learned from the credit crisis, action must not wait for substantial identified risks to materialize—especially at the expense of taxpayers and investors who are still feeling the effects of the last government bailout. I urge the Agencies to heed this lesson of the credit crisis.[23] Regulatory guidance is needed now to create robust and effective risk management and eliminate undue risk-taking and anti-competitive behavior. I therefore urge the Agencies to adopt its Proposed Guidance on Leveraged Lending and to add the simple par standard suggested above.

Sincerely,

Byron L. Dorgan

Byron L. Dorgan

---

23 Deputy Comptroller Wilson stated it well in testimony last year:

> "One of the lessons we learned is the detrimental effect of waiting too long to warn the industry about excesses building up in the system, resulting in bankers and examiners slamming on the brakes too hard when the economy experienced problems. This is one reason why we are working to develop better tools that will enable us to identify signs of accelerating risk taking at an earlier stage when our actions can be more modulated."

Testimony by David K. Wilson, Deputy Comptroller, Credit and Market Risk, Office of the Comptroller of the Currency, before the Subcomm. On Fin. Institutions and Consumer Protection, Sen. Comm. On Banking, Housing, and Urban Affairs, at 16 (June 15, 2011), *available at* http://www.occ.gov/news-issuances/congressional-testimony/2011/pub-test-2011-72-written.pdf

From:	Chris Roth
To:	Regs.Comments
Cc:	Mike Lempres
Subject:	Comment Letter from SVB Financial Group - Docket Number OCC-2011-0028 (Proposed Leveraged Lending Guidance)
Date:	Friday, June 08, 2012 6:53:36 PM
Attachments:	SVB_Financial_Group_Docket_OCC-2011-0028.pdf

To Whom It May Concern:

In connection with the Proposed Guidance on Leveraged Lending, please find attached a comment letter submitted on behalf of SVB Financial Group by Michael Lempres, Assistant General Counsel and Practice Head. Should you have any questions or issues opening this document, please let us know. Thank you for your time and consideration.

Best Regards,

CHRIS ROTH
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Legal Department, Government Affairs
Silicon Valley Bank
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SVB Financial Group

June 8, 2012

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Washington, DC 20219
Submitted Via Email To: regs.comments@occ.treas.gov

Board or Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Jennifer J. Johnson, Secretary
Submitted Online Via www.regulations.gov

Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Submitted Online Via www.regulations.gov

***Re:* Proposed Guidance on Leveraged Lending** (Docket Nos. OCC- 2011-0028 & OP-1439)

Dear Ladies and Gentlemen:

SVB Financial Group ("*SVB*") is pleased to submit these comments in response to the Agencies on the Proposed Guidance on Leveraged Lending ("Proposed Guidance" or "Proposal")[1]. At SVB, we have a strong interest in many aspects of the Proposed Guidance and focus our comments here on three major areas: (1) the Proposed Guidance seems intended to address a problem that most banks, including SVB, do not present; (2) the Proposal adds to an enormous new regulatory burden that banks already face; (3) the Proposal should be revised to define leveraged lending by focusing more on actual risk. For issues that go beyond the three that we raise here, we fully support and join in the comments submitted by the Loan Syndications and Trading Association ("LSTA") and the American Bankers Association ("ABA") in their joint letter of June 8, 2012.

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

I. Overview

At SVB we believe very strongly in the importance of identifying and mitigating risk on an enterprise wide basis, and we applaud the Agencies for continuing to focus on the need for financial institutions to provide leveraged finance in a safe and sound manner. We also support the Agencies' fundamental approach of issuing guidance, rather than issuing rules in this area. The Proposal provides criteria that can be applied across a variety of different circumstances. The SVB business model is unique, and working with our primary regulator, we have developed a process that works for us, our clients, our regulators and others in the area of leveraged lending. Rather than applying a one-size-fits-all regulatory approach, the Proposed Guidance could permit a more tailored application of regulatory principles. Accordingly, we express concerns about specific provisions of the Proposal, but we strongly support the Agencies' decision to apply guidance.

Leveraged lending fulfills a necessary and important purpose in providing credit to deserving businesses. In the high-growth technology and innovation sector we serve, leveraged finance is an important component of economic growth and job creation. We support and agree with the Proposed Guidance's conclusion that:

> *Leveraged finance is an important type of financing for the economy, and the banking industry plays an integral role in making credit available and syndicating that credit to investors. Institutions should ensure that they do not heighten risks by originating poorly underwritten deals that find their way into a wide variety of investment instruments*[2].

It is because we believe that leveraged financing is important to the economy that we express concern about the regulatory burden that <u>may</u> be present in the Proposal. We are a mid-size institution, and leveraged lending is a relatively modest part of our overall portfolio. Like all other financial institutions, we are facing an extraordinary increase in the cumulative regulatory burden that we must meet. At some point, that burden will reduce our ability to extend credit, and that inability to extend credit will not be due to substantive credit decisions; it will be due to the cost of regulations. The Proposed Guidance may result in extensive costs that bring institutions closer to the point where credit decisions are driven by the question of how to allocate resources made scarce by unnecessary regulations.

II. Background on SVB Financial Group

SVB is a publicly traded bank and financial holding company. Our principal subsidiary, Silicon Valley Bank, is a California-chartered bank and a member of the Federal Reserve System. As of December 31, 2011, SVB had total assets of $20 billion.

We are the premier provider of financial services for start-up and growing companies in the technology, life science, and clean technology sectors, as well as the venture capital

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[2] Proposed Guidance at 19,424.

funds that finance their growth. Over nearly thirty years, we have become the most respected bank serving the technology industry. We have developed a comprehensive array of banking products and services specifically tailored to meet our clients' needs at every stage of their growth. Today, we serve roughly half of the venture-backed high growth start-ups across the United States and well over half of the venture capital firms, working through 27 U.S. offices and international offices located in China, India, Israel and the United Kingdom.

While we have grown significantly over the last few years, [3] we maintain the highest standards for credit quality and capital and liquidity management. Our credit quality throughout the recent downturn was comparable to peer institutions at its worst and better than most peers through the recession's trough.[4] Our ability to lend actively to our clients while maintaining strong credit quality reflects our commitment to provide the credit our clients need to grow, our deep understanding of the markets we serve, and the fundamental strength of the technology sector. As one measure of our performance, Forbes Magazine recently listed SVB as one of the ten best performing banks in the United States, for the third year in a row.[5]

SVB maintains a portfolio of leveraged loans that reflects our focus on growing technology and life science companies. The portfolio is generally maintained at approximately $350 million and is defined, tracked and reported quarterly according to FFIEC 031 standards. The vast majority of the leveraged loans are sourced and managed by a dedicated leveraged lending team that is highly skilled at underwriting and monitoring leveraged loans and has strong relationships with a select number of equity sponsors some of which are SVB clients. The leveraged lending team has been in place for a number of years and has maintained an excellent credit track record. Most of our leveraged loans are either sole bank or smaller syndicated or club transactions, and we have de-emphasized the larger, widely syndicated, more aggressive loan structured credits. We monitor our leveraged loan portfolio quarterly and review each credit annually. As many of the leveraged loans are to companies which were clients at an earlier stage, the leveraged lending team is an important component of our strategy in helping our technology and life science clients grow.

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[3] Loan amounts are period-end balances net of unearned income as of December 31, 2007 and December 31, 2011. The loan growth comparison is based on an SVB analysis, using data from the Federal Financial Institutions Examination Council ("FFIEC"), which showed that between the third quarter of 2009 and the third quarter of 2011 SVB grew its loan portfolio by 36% while peer institutions, on average, grew their loan portfolios by 11%.

[4] SVB analysis based on FFIEC data.

[5] "America's Best and Worst Banks," Forbes Magazine. 2009, 2010, 2011. Forbes' rankings are based on institutions' financial performance (return on equity), credit quality (non-performing loans as a percent of total loans and loan loss reserves as a percent of non-performing loans), and capital/liquidity strength (tier 1 ratio and leverage ratio).

III. SVB's Leveraged Lending Portfolio Presents None of the Risks Identified as the Purpose of the Proposed Guidance

In the "Purpose" section of the Proposal, the Agencies state the reason they believe new guidance is required to update the existing 2001 Guidelines.[6] The Proposal states:

> *[T]he pipeline of aggressively priced and structured commitments has grown rapidly [since 2001]. Further, management information systems (MIS) at some institutions have proven less than satisfactory in accurately aggregating exposures on a timely basis, and many institutions have found themselves holding large pipelines of higher-risk commitments at a time when buyer demand for risky assets diminished significantly.*
>
> *In light of these changes, the Agencies have decided to replace the 2001 Guidance with new leveraged finance guidance.*

Fundamentally, SVB does not put itself at risk of holding large pipelines of leveraged loan commitments. We operate a leveraged loan portfolio within strict limits that are not aggressive by prudent industry standards. As noted above, most of our leveraged loans are either sole bank or smaller syndicated or club transactions. As a matter of policy and practice, we have generally avoided the larger, widely syndicated, more aggressive loan structured credits. As to SVB, the Proposal's concern about the consequences that result when demand for "risky assets" diminishes is misplaced. Leveraged loans provide an important service to our clients, and when conducted as part of larger credit portfolio and process, we believe they are entirely consistent with safety and soundness principles and with the prudent operations of a financial institution.

From our standpoint, the new Proposed Guidelines would not result in improved lending operations or increased safety and soundness for our institution. The Proposed Guidelines appear designed to solve a problem that most financial institutions, including SVB, do not face. In this way, the Proposal provides little benefit to either the public or consumers.

IV. The Proposed Guidance Adds to an Enormous New Aggregate Regulatory Burden that Disproportionately Harms Mid-Size Institutions

The cost of complying with the Proposed Guidance appears to be substantial. Mid-size and smaller institutions already face a disproportionate burden in meeting the compliance obligations imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Dodd-Frank Act consists of 2,319 pages of text, and it requires a minimum of nearly 400 new rules and 87 new studies. This Proposed Guidance is not required by the Dodd-Frank Act, but it is another layer of regulation with which institutions must comply. Large institutions have the resources to meet the additional compliance obligations. Smaller and mid-size institutions must make decisions about where to get the resources to apply to meeting regulatory obligations. Some of those resources necessarily come from providing banking services to the

[6] SR 01-9, "Interagency Guidance on Leveraged Financing," April 17, 2001, OCC Bulletin 2001-8, FDIC Press Release PR-28-2001.

public. The result will be fewer loans and less credit for consumers and businesses. It also means that the government will strengthen the competitive advantage given to "too big to fail" large institutions and that those institutions will continue to grow.

We recognize that the Proposal contains guidance and is not a proposed Rule, and we appreciate the Agencies' analysis under the Regulatory Flexibility Act. It is difficult to analyze the precise regulatory demands of the Proposed Guidance because it is guidance. Much of the compliance burden appears to rest within the discretion of regulators and examiners. While this provides flexibility, it does not permit certainty. In today's environment of increased regulatory burdens, the lack of certainty makes it more difficult to plan.

The Proposed Guidance is likely to result in substantially increased compliance obligations. The ABA/LSTA Joint Letter estimates that one-time set ups of the MIS systems required by this Proposal would require 5,000-10,000 hours per institution. The Agencies' estimates of the average time required for an institution to comply with the Proposed Guidance seem to be low by orders of magnitude, even given that none of us know how the Proposed Guidance will play out in practice.

At SVB, we operate a constrained leveraged loan practice that is not a large portion of our overall credit portfolio. Even given that, we anticipate the MIS and other compliance demands may require something near the 5,000 hour estimate. Changing our existing MIS systems to comply with the new guidance will take an extended period of time, particularly when these changes rest on top of the numerous systems changes required by the Dodd-Frank Act. It is essential that once new requirements are identified and clarified, regulators provide for a substantial transition period. It may require 18-24 months or more for an institution like ours to design, build and operate the systems changes contemplated in the Proposal.

We agree strongly with the Agencies' general statement that smaller institutions should "discuss with their primary regulatory implementation of cost-effective controls appropriate for the complexity of their exposures and activities."[7] That principle should be explicitly extended to mid-size institutions, like SVB, so that we can develop a tailored response that avoids the unnecessary negative consequences that will follow such a large resource commitment to compliance.

V. The Definition of Leveraged Lending Should Be Revised to Reflect Risk More Accurately

We agree with the Agencies' assertion that financial institutions use a variety of definitions of leveraged finance and that flexibility in the definition is important. We support the use of criteria that may be used to define leveraged finance, but the definition ultimately should focus on the risk presented by the loan. Safe and sound underwriting decisions require qualitative judgments about a complex series of factors that provide a complete assessment of risk. These judgments will be specific to the practices and portfolios of individual banks and cannot be reduced to purely quantitative criteria.

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[7] Proposed Guidance at 19,419.

As we read the Proposal, it seems to treat all leveraged loans as though they carry the same risk, regardless of the risk rating. The Proposal does not seem to distinguish between, for example, a CRR3 credit and a CRR5 credit. That is a distinction with a difference, and the Proposal should recognize that those different rated loans should require different levels of monitoring and reporting scrutiny. Moreover, the Proposal should be clarified to state that the character of loans can change over time, and loans can migrate out of the leveraged loan category. As a loan is repaid and/or EBITDA grows, leverage may be reduced below the leverage definition determined by the bank, such as 3x SFD/EBITDA and/or 4x TFD/EBITDA, and that loan should not be forever considered highly leveraged when it no longer presents such a risk.

VI. Conclusion

On behalf of SVB, I thank you for your willingness to consider our concerns and suggestions for improvements to the Proposed Guidance on Leveraged Lending. Please contact me if we may provide any more information or be of help in your consideration of this matter.

Sincerely,

Michael Lempres
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SVB Financial Group
Direct: (650) 320-1142
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June 8, 2012

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

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of Currency
250 E Street, SW
Washington, DC 20219

Re: Proposed Guidance on Leveraged Lending; Docket ID OCC-2011-0028; OP-1439

Dear Ms. Johnson, Mr. Feldman, and To Whom It May Concern:

Our organizations represent all sectors of the economy, speaking on behalf of businesses that employ tens of millions of workers domestically. Because our members need access to a variety of different forms of capital to provide the resources for operations, expansion and job creation, we support strong risk management practices and the appropriate level of controls needed to insure responsible and sustainable business lending. As such, we appreciate the opportunity to provide comment on the Proposed Guidance on Leveraged Lending ("proposed guidance") issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve (Federal Reserve") and the Federal Deposit Insurance Corporation ("FDIC") (also collectively known as the "Agencies").

While we agree that unreasonable risk-taking should be mitigated to the extent possible, we firmly believe that reasonable risk-taking is a necessary ingredient for the free enterprise system to work. Accordingly, we believe that sound risk management and lending controls are an important part of leveraged lending. The proposed guidance is an important step to achieving that goal, but it should avoid artificial bright line tests that do not allow for capital to be allocated efficiently as lenders may defer to these artificial ratios and tests rather than taking into account the specific characteristics of a business. Strict bright line tests could impede capital flows and have negative impacts upon business expansion and job creation.

Companies small and large, particularly new businesses, need a mix of capital sources to meet short-term and long-term growth needs, including but not limited to debt markets, equity markets, bank loans, trade finance, angel investing, venture capital, credit cards, home equity loans, etc. This diversity of capital has provided the liquidity needed for different sized firms to be able to have the opportunity to achieve success. Businesses need a mosaic of interconnected products of varying size and complexity to meet the capital needs of a 21st century global economy. Leveraged lending is a part of that capital formation mosaic.

Strong risk-management practices and monitoring of borrower performance are the hallmarks of business lending including leveraged financing. This also requires lenders to understand the unique characteristics, prospects, and maturity of a business. Lending and capital deployment decisions are subject to a consideration of factors unique to a business and not subject to a one size fit all approach. Therefore, lending decisions should be based upon credit analysis and risk based judgments rather than bright line tests.

We are concerned that some aspects of the proposed guidance are too prescriptive in nature and inconsistent with accepted practice and procedures of leveraged lending. The Agencies appear to adopt definitions of leverage financing based upon ratios without providing commenters with an understanding of how the ratios are constructed. Rather, we believe that financial institutions should be able to develop industry and sector definitions that take into account historic norms, lending history, and risk management considerations. Similarly, underwriting practices and treatment of covenants need to reflect standard practices on an industry by industry basis rather than bright line rules that may encompass some but not all industries. Such a one size fits all approach can lead to practices that misallocate capital and have negative consequences for the economy.

In the release of the proposed guidance, the Agencies acknowledge that information collection will be required as a part of implementing the proposal. Similarly, no cost-benefit analysis is provided as a part of the proposed guidance. Therefore, it is difficult for commenters to understand the burdens imposed upon parties subject to the guidance and the costs that may accrue to the overall economy. Accordingly, we recommend that the proposed guidance be subject to a regulatory review process by the Office of Information and Regulatory Affairs ("OIRA").

Thank you for the opportunity to comment on the proposed guidance and we would be happy to meet and discuss these concerns in fuller detail. We believe that the proposed guidance relies too much on bright-line tests and fails to account for industry practices and approaches taking into consideration industry and business specific consideration. This approach may stratify lending practices and fail to allow worthy companies of having access to capital. Addressing these concerns will provide for guidance that will allow for efficient leveraged lending balanced with reasonable risk taking.

Sincerely

Tom Quaadman	Chip Rodgers
Center for Capital Markets Competitiveness	The Real Estate Roundtable
U.S. Chamber of Commerce	

From:	suzanne.alwan@wellsfargo.com
To:	Regs.Comments; regs.comments@federalreserve.gov; comments@FDIC.gov
Cc:	mckhann@wellsfargo.com; Paul.R.Brenner@wellsfargo.com
Subject:	Proposed Leveraged Lending Guidance; Docket Number OCC-2011-0028; Docket Number OP-1439
Date:	Friday, June 08, 2012 9:01:02 PM
Attachments:	20120604181250.pdf

Ladies and Gentlemen,

Attached is a letter supporting the comment letter submitted today by the LSTA and the ABA with respect to the Proposed Leveraged Lending Guidance, dated March 30, 2012. Please feel free to contact me or others copied on this email with any questions or concerns.

Best regards,
Suzanne Alwan

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June 8, 2012

BY ELECTRONIC SUBMISSION

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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)

Dear Ladies and Gentlemen:

Wells Fargo & Company, and its subsidiary insured depository institutions, including Wells Fargo Bank, N.A. (collectively, "Wells Fargo" or "we"), appreciates the opportunity to comment on the Proposed Leveraged Lending Guidance published by the Office of the Comptroller, Treasury ("OCC"), Board of Governors of the Federal Reserve System ("Board" or "Federal Reserve"), and the Federal Deposit Insurance Corporation ("FDIC", and collectively with the OCC and the Board, the "Agencies") in the Federal Register on March 30, 2012 (the "Proposed Guidance")[1]. We continue to support the Agencies efforts to ensure that financial institutions provide leveraged financing in a safe and sound manner.

We fully endorse the positions outlined in the joint comment letter regarding the Proposal from the Loan Sales and Trading Association and the American Bankers Association (together, the "Associations").

We appreciate the opportunity to provide our comments and concerns regarding the Proposed Guidance and join in the positions outlined in detail in the Associations' joint comment letter. We welcome the opportunity for further discussions. If you have any questions, please contact the undersigned at (704) 383-6298.

Sincerely,

Suzanne V. Alwan
Managing Counsel

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

CapitalSource Bank

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June 8, 2012

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