Client Update
Leveraged Lending Guidance: What Comes Next?

On October 19, 2017, the U.S. Government Accountability Office (the “GAO”) determined that the March 2013 Interagency Guidance on Leveraged Lending[1] is a “rule” subject to the procedural requirements of the Congressional Review Act (the “CRA”).[2] The CRA requires such a rule to be submitted to Congress for review and, potentially, disapproval, before it can take effect. The legal and practical impact of the GAO determination is not yet clear, but the focus on the future of the leveraged lending guidance will continue.

THE DEBATE SURROUNDING THE LEVERAGED LENDING GUIDANCE AND THE ROLE OF THE CRA

The leveraged lending guidance, issued jointly by the Federal Reserve Board, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (the “Agencies”) requires lenders subject to the Agencies’ respective jurisdiction to consider a borrower’s de-leveraging capacity as part of the lender’s risk rating analysis. One aspect of the guidance that has garnered significant attention over the years is the statement that a leverage level of higher than 6x total EBITDA “raises concerns” for borrowers in “most industries.”[3]

This and other aspects of the leveraged lending guidance have been subject to scrutiny and criticism.[4] This scrutiny intensified with the new presidential administration in Washington, D.C. In March 2017, Senator Pat Toomey (R-Pa) requested that the GAO determine whether the guidance is a “rule” that is subject to the CRA’s procedural requirements. In short, the CRA

[1] 78 Fed. Reg. 17766 (Mar. 22, 2013).

[2] 5 U.S.C. § 801(a).

[3] For more detail on the leveraged lending guidance, see our client update “New Banking Guidance May Impact Leveraged Lending” (Apr. 24, 2013), available here.

[4] To address uncertainty arising from the guidance, the Agencies issued FAQs, as discussed in our client update “Regulators Clarify Leverage Lending Guidance” (Nov. 11, 2014) (noting that the “imprecise nature of the Guidance created uncertainty” leading to the issuance of a Frequently Asked Questions for Implementing March 2013 Interagency Guidance on Leveraged Lending), available here.

requires certain regulatory actions that fall within its definition of a "rule" to be submitted to Congress for review; Congress then has the opportunity to vote to disapprove the rule.[5] Senator Toomey's request presented the question whether the guidance should have been submitted and the potential consequences of the fact that it had not been.

In June 2017, before the GAO responded to Senator Toomey's letter, the U.S. Treasury Department stated that the guidance is ambiguous and leaves banks unsure how to satisfy its standards and, as a result, restricts the provision of credit to the economy. To cure these faults, the Treasury recommended that the Agencies reissue the guidance and once again seek public comment.[6] However, the Agencies did not take such action.

The immediate effect of the GAO's recent determination that the guidance is a "rule" subject to the CRA's requirements is not clear (and the GAO did not opine on what such effects might be). In particular, it is not clear whether the Agencies are obliged to submit the guidance to Congress for review or may continue to act in accordance with their view that the guidance is not a rule.

In all events, the effect of the GAO's determination and possible next steps will be a continuing focus for the industry, the Agencies and other interested parties. Further, because the Agencies frequently issue various forms of supervisory guidance, often without notice and comment, the GAO's determination, if read and applied broadly, could raise important policy questions about such Agency pronouncements.

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Please do not hesitate to contact us with any questions.

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[5] 5 U.S.C. §§ 801(a)(1)(A)-(3). As one example of the use of this authority, Congress recently voted to disapprove a rule adopted by the Consumer Financial Protection Bureau regarding the use of mandatory arbitration. *See* Andrew Ackerman and Yuka Hayashi, "Congress Makes It Harder to Sue the Financial Industry," *The Wall Street Journal* (Oct. 24, 2017), https://www.wsj.com/articles/congress-votes-to-overturn-cfpb-arbitration-rule-1508897968.

[6] U.S. Department of the Treasury Report, "A Financial System that Creates Economic Opportunities: Banks and Credit Unions," at 103-105 (June 12, 2017). The guidance was originally subject to public comment in 2012. *See* 77 Fed. Reg. 19417 (Mar. 30, 2012).

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