Joint Release	**Board of Governors of the Federal Reserve System** **Federal Deposit Insurance Corporation** **Office of the Comptroller of the Currency**

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Agencies Issue Updated Leveraged Lending Guidance

WASHINGTON—Federal bank regulatory agencies today released updated supervisory guidance on leveraged lending, which has been increasing since 2009 after declining during the financial crisis.

The guidance from the Federal Reserve Board, the Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (the agencies) covers transactions characterized by a borrower with a degree of financial leverage that significantly exceeds industry norms. The guidance replaces guidance issued in April 2001.

Before the financial crisis, the volume of leveraged credit transactions grew tremendously and participation by non-regulated investors willing to accept looser terms increased. While leveraged lending declined during the crisis, volumes have since increased and prudent underwriting practices have deteriorated. For example, some debt agreements have included features that weaken lender protection by excluding meaningful maintenance covenants and including other features that can limit lenders' recourse in the event of weakened borrower performance. In addition, capital and repayment structures for some transactions, whether originated to hold or to distribute, have been aggressive. Management information systems at some institutions have proven less than satisfactory in accurately aggregating exposures on a timely basis.

It is important that banks provide leveraged financing to creditworthy borrowers in a safe and sound manner.

The guidance issued today focuses attention on the following key areas:

- Establishing a sound risk-management framework: The agencies expect that management and the board of directors identify the institution's risk appetite for leveraged finance, establish appropriate credit limits, and ensure prudent oversight and approval processes.

- Underwriting standards: An institution’s underwriting standards should clearly define expectations for cash flow capacity, amortization, covenant protection, collateral controls, and the underlying business premise for each transaction, and should consider whether the borrower’s capital structure is sustainable, regardless of whether the transaction is underwritten to hold or to distribute.

- Valuation standards: An institution’s standards should concentrate on the importance of sound methods in the determination and periodic revalidation of enterprise value.

- Pipeline management: An institution should be able to accurately measure exposure on a timely basis; establish policies and procedures that address failed transactions and general market disruptions; and ensure periodic stress tests of exposures to loans not yet distributed to buyers.

- Reporting and analytics: An institution should ensure that management information systems accurately capture key obligor characteristics and aggregates them across business lines and legal entities on a timely basis, with periodic reporting to the institution’s board of directors.

- Risk rating leveraged loans: An institution’s risk rating standards should consider the use of realistic repayment assumptions to determine a borrower’s ability to de-lever to a sustainable level within a reasonable period of time.

- Participants: An institution that participates in leveraged loans should establish underwriting and monitoring standards similar to loans underwritten internally.

- Stress testing: An institution should perform stress testing on leveraged loans held in portfolio as well as those planned for distribution, in accordance with existing interagency issuances.

This guidance applies to financial institutions supervised by the agencies that engage in leveraged lending activities. The number of community banks with substantial involvement in leveraged lending is small and they should be largely unaffected by this guidance.

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Attachment:
Interagency Guidance on Leveraged Lending - PDF (PDF Help)

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