

March 1, 2018

OCC Head Says Banks Need Not Comply with Leveraged Lending Guidance

The head of the Office of the Comptroller of the Currency (the “OCC”) announced at a conference in Las Vegas on Tuesday that banks no longer need to adhere to Leveraged Lending Guidance (the “Guidance”) when providing leveraged financing. In response to a question from the audience, Joseph Otting of the OCC said that “Institutions should have the right to do the leveraged lending they want, as long as they have the capital and personnel to manage that and it doesn’t impact their safety and soundness.” And in a conversation with the debt news media after the session, Otting stated that he expects leverage ratios to trend upward over the next year.

The Leveraged Lending Guidance, which was introduced in 2013 in the wake of the financial crisis, caps pro forma leverage for leveraged financings at 6x and also requires that a company be able to amortize at least 50% of its debt within 5-7 years of closing. In the years that followed promulgation of the leveraged lending guidelines, banks and sponsors often found themselves unable to do certain deals in the face of scrutiny from regulators who were focused on leverage, the nature of various EBITDA addbacks, and the strength of loan covenants. The regulators’ critical focus on the banks’ leveraged finance business proved to be an unintended boon to non-regulated lenders, whose market share of deals in the leveraged finance space has grown significantly as a result of their not being subject to the Guidance.

Mr. Otting’s comments were not entirely a surprise. In October 2017, the U.S. Government Accountability Office (the “GAO”) determined that Leveraged Lending Guidance was a “rule” subject to the procedural requirements of the Congressional Review Act (the “CRA”), meaning that the Guidance has to be submitted to Congress for review before it can lawfully take effect. Parties have been left wondering about the practical import of the GAO decision since October, and whether the Guidance was ever and/or still is in effect. While the other agencies who promulgated the guidance, namely, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, have not (yet) stated publicly that the Guidance is of no further effect, Mr. Otting’s remarks yesterday do seem to indicate as much. The final procedural step would be for Leveraged Lending Guidance to be disapproved after its CRA review, which may or may not be on the horizon.