Simpson Thacher

Memorandum

U.S. Leveraged Lending Guidance Under Scrutiny: GAO Concludes that Congressional Review Is Necessary

October 20, 2017

Yesterday, the U.S. Government Accountability Office ("GAO") determined that guidance issued by the federal banking agencies in 2013 relating to leveraged lending constituted a "rule" for purposes of the Congressional Review Act of 1996. The GAO's determination was made in response to an inquiry by Senator Pat Toomey earlier this year.

The leveraged lending guidance—jointly issued by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation—was not in the form of a rule or regulation, but rather guidance that outlined "minimum expectations" relating to underwriting standards, risk rating, problem credit management and other topics.[1] It has become an important, and controversial, area of compliance for banks in recent years. One of the more notable features of the guidance is the statement that a financing that leaves a company with debt of more than six times its earnings before interest, taxes, depreciation and amortization, or EBITDA, "raises concerns for most industries." The 6x total debt-to-EBITDA reference became a key focal point for the agencies, particularly in the initial year of the guidance's effectiveness, and many large arranging banks were reported to have received confidential regulatory letters relating to compliance with these standards. In the years following the promulgation of the guidance, the market experienced greater uncertainty in underwriting standards, with banks appearing to be more reluctant to underwrite some highly leveraged loan transactions, and non-regulated arrangers assuming a greater role in underwriting certain leveraged buyouts and other highly leveraged financings.

In the GAO's view, the leveraged lending guidance was more than guidance, and the GAO expressly rejected arguments by the agencies that it was only a general statement of policy of how they will exercise their broad

[1] *See* Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17766 (Mar. 22, 2013). For general background, please see our memorandum, titled "Federal Banking Agencies Revamp Guidance on Leveraged Lending," dated March 27, 2013, *available* here.

enforcement discretion. The GAO's determination is important because it means that the guidance must be submitted to the Congress for review.

The Congressional Review Act generally requires all federal agencies to submit a copy of each new rule and other accompanying information to Congress prior to a rule's effectiveness. Congress then generally has 60 legislative days to disapprove. If a joint resolution of disapproval is passed by Congress (by a simple majority of each chamber), and signed by the President, the Congressional Review Act provides that the "rule shall not take effect (or continue)," which means that the rule would be deemed not to have had any effect at any time.

Until recently, the Congressional Review Act was a relatively obscure law that was rarely invoked to overturn rules. However, since the election of President Trump, Republicans have used the law to repeal a number of regulations approved during the Obama Administration. Whether the leveraged lending guidance will face the same fate remains to be seen, but borrowers and lenders will both be carefully monitoring developments.

For additional information, please contact any member of the Banking and Credit or Financial Institutions practices, including those listed below.

BANKING AND CREDIT

Patrick J. Ryan
+1-212-455-3463
pryan@stblaw.com

James D. Cross
+1-212-455-3386
jcross@stblaw.com

FINANCIAL INSTITUTIONS

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Mark J. Chorazak
+1-212-455-7613
mchorazak@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000