

Leveraged Lending—A New Era for Guidance Issued by the Banking Agencies?

November 6, 2017 | Client Update | 6-minute read

The [Leveraged Lending Guidelines](#) are in an uncomfortable state of limbo. After the [GAO ruling](#) that the Guidelines are a “rule” under the Congressional Review Act, they are no longer effective as guidance, but the silence from the OCC, the Federal Reserve, and the FDIC has been deafening.[1] The uncertainty poses challenges for any bank trying to manage a leveraged lending business. The concern for banks is whether the banking agencies, despite the ineffectiveness of the Leveraged Lending Guidelines, might still apply them in the confidential examination context.

A recent [letter](#) sent by Representative Blaine Luetkemeyer (R-MO), in his capacity as Chairman of the House Subcommittee on Financial Institutions and Consumer Credit, puts this concern front and center. He requests that the banking agencies confirm that they are no longer applying the Leveraged Lending Guidelines to make confidential supervisory determinations or examination criticisms, or to issue any matters requiring attention (MRAs) or matters requiring immediate attention (MRIAs) as a result of any examination. Representative Luetkemeyer’s letter points to conflicting public statements that reflect an institutional understanding that the Leveraged Lending Guidelines were construed by some regulatory staff as binding in nature in the examination process.[2] His comments accord with a common frustration of regulated entities that guidelines may be applied in the context of an examination as a binding regulation, rather than a prudential standard meant to inform an examiner’s discretionary assessment in light of particular circumstances.

The Luetkemeyer letter also highlights that the GAO determination has implications for banking agency guidance that sweep far beyond the Leveraged Lending Guidelines. He asks the banking agencies to review all outstanding guidance to determine which among them would also be a “rule” and thus subject to congressional review. This will be a large task as the use of guidance is a long-standing tradition at the banking agencies.

What is at stake is a reframing of how the banking agencies approach the balance between the exercise of their prudential discretion and the need for a transparent and fair way to impose new standards that impact the economy and the financial sector. There has long been a tension between the Administrative Procedure Act’s requirement of public engagement and the banking agencies’ culture of discretion and confidentiality. The agencies’ approach to prudential supervision, including bank examination practices, developed in the days before the creation of deposit insurance with the understanding that secrecy was essential to guard against bank runs and contagion. But the culture of discretion and confidentiality sometimes sits uncomfortably within the confines of the regulatory process required by post-New Deal legislation, including the APA, with its emphasis on transparency, public engagement, and checks from other parts of the government.[3]

The banking agencies have created a number of standard-setting guidance documents that have not been through notice and comment procedures, including those related to CCAR, model risk management, and living wills. Even those who support the broad goals underlying such guidance may concede that guidance can be improved through public notice and comment, which is typically required for a regulation. First, this public engagement provides an opportunity to inform the policy with a balancing of the costs with respect to economic growth against the benefits with respect to financial stability. Second, it provides a forum where regulators can think through with the private sector the scope of how the new standards might apply in a market that is known and understood by its players, clarifying application while avoiding unintended consequences. Of course, the regulators and the regulated will often disagree on policy and that is how it should be. But policy should not be made and imposed behind closed doors without public engagement.[4]

Representative Luetkemeyer's request for a review of all banking agency guidelines, a request that the banking agencies may have anticipated for some months, may explain their silence. In prudential regulation, there is a need for supervisory discretion and regulated entities will still appreciate interpretive guidance from the agencies as to how that discretion will be applied. But, when interpretive guidance functions as a binding constraint with fundamental public policies at stake, the balance should tilt in favor of transparency and the opportunity for public participation. The cultural shift has been a long time coming, and the time is right to reconsider the intersection of banking regulations and administrative procedures.

[1] There has been a surprising amount of confusion in commentary about what the GAO determination means. For us, the best recitation of the basics is in this TCH blog [here](#). The limbo arises because the next move rests, likely jointly, with the banking agencies who must decide whether they will send the Leveraged Lending Guidelines, as is, to Congress for review under the CRA or, as recommended in the [Treasury Report on Banks and Credit Unions](#), revise them in some way. In light of the fact that the banking agencies did not send the Leveraged Lending Guidelines to Congress when they were issued, it is unclear whether the 60 Senate session day clock has started. Normally, an agency would send the “rule” to Congress when it was first issued, but here the Leveraged Lending Guidelines have not been sent and it will be up to the Congressional parliamentarians to decide if inserting the GAO ruling in the Congressional Record is sufficient to constitute receipt of the Leveraged Lending Guidelines by Congress for purposes of the CRA.

[2] The question of whether the Leveraged Lending Guidelines should have been promulgated through a rulemaking subject to the notice and comment requirements under the APA is separate from the question of whether they are a “rule” under the Congressional Review Act. Under 5 U.S.C. § 553(b), informal rulemakings are subject to notice and comment requirements, unless they qualify for an exemption, including, among others, the exemptions for “interpretative rules [and] general statements of policy.” Courts have developed tests to determine whether guidance was appropriately issued, or should have been promulgated through informal rulemaking. See e.g., *Nat’l Mining Ass’n v. McCarthy*, 758 F.3d 243, 252-53 (D.C. Cir. 2014)(setting out a three part test: (1) “the actual legal effect (or lack thereof) of the agency action in question on regulated entities”; (2) “the agency’s characterization of the guidance”; and (3) “whether the agency has applied the guidance as if it were binding on regulated parties”).

[3] An earlier version of what became the APA—which passed both the House and the Senate, but was vetoed by President Franklin D. Roosevelt in 1940—would have exempted the Federal Reserve, the OCC, and the FDIC. See George B. Shepherd, *Fierce Compromise: The Administrative Procedure Act Emerges from New Deal Politics*, 90 Nw. U. L. Rev. 1557, 1683 (1995-1996), available at [this link](#). While the APA as finally enacted in 1946 included the banking agencies, the cultural tendency by the banking agencies to view themselves as somehow not quite part of the APA continued. See Gillian E. Metzger, *Through the Looking Glass to a Shared Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 L. & Contemp. Probs. 129-156 (2015), available at [this link](#).

[4] Operation Chokepoint is another example. See Michael S. Barr, Howell E. Jackson, Margaret E. Tahyar, *Financial Regulation: Law and Policy* 222 (2015).

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