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Recent Regulatory Developments for the Credit Markets

The credit markets continue to be subject to significant regulatory change. Recently, two steps have been taken that are intended to increase the ability of certain types of creditors to expand the availability of credit. *First*, the leverage limits applicable to BDCs pursuant to section 61(a) of the Investment Company Act of 1940 were amended to reduce asset coverage requirements on securities issued by them from 200% to 150%, subject to the satisfaction of certain initial approval and reporting requirements.[1] *Second*, in a recent public forum, the Comptroller of the Currency, Joseph M. Otting, stated that so long as national banks conducted their lending activities "safely and soundly" national banks may make leveraged loans regardless of the wording of the 2013 Guidelines.[2] These recent developments create opportunities for both adaptation and caution for applicable participants in the credit markets.

A national bank that wishes to rely on the Comptroller's remarks could pursue at least three forms of adaptation: (i) increasing the size of the loans it funds; (ii) lending to borrowers that previously were considered ineligible; and (iii) revamping aspects of its compliance procedures. The first two options would arise under new internal standards for degrees of indebtedness and financial capacity established by such bank that differ numerically or otherwise from those set forth in the 2013 Guidelines. Any changes to those internal standards would affect both the profitability of their own leveraged loan portfolio and in addition the structure of this segment of the lending market generally, reducing the current significant gap between the lending policies of bank and non-bank lenders.

The third form of adaptation results from the residual requirement on a national bank to maintain safety and soundness in its portfolio. Because banks must maintain substantial compliance systems independent of their leveraged lending activities, the nature and scope of any changes will likely vary substantially. However, given the Comptroller's express reference to safety and soundness, it seems reasonable to expect that banks will at least need to develop or carefully formulate the safety and soundness considerations they wish to apply to leveraged loans in the future. Reliance on a general notion of safety and soundness may lead to greater

uncertainty during examinations and a different set of, perhaps tacit, "guidelines" is likely develop out of regulatory practice. Since banks have multiple regulators, some additional uncertainty may arise from the potentially different and perhaps inconsistent perspectives that the various regulators have. In this context, it is important to recall that the 2013 Guidelines were drafted to address two kinds of safety and soundness: that of individual banks and that of the system as a whole. Accordingly, it will be interesting to see the extent to which banks will be expected to justify a macro-prudential component of their individual leverage lending compliance. In the absence of any such macro-prudential component, it will be important to determine whether the regulators impose something like the 2013 Guidelines in a new form in the exercise of their macro-prudential responsibility.

King & Spalding will continue to monitor legal and business developments in credit markets in working together with clients to structure transactions in response to those developments.

[1] An amendment to the U.S. Investment Company Act of 1940, as amended (the "**1940 Act**") enacted pursuant to the Small Business Credit Availability Act included as part of the Consolidated Appropriations Act of 2018, the spending bill passed by Congress and signed into law by President Trump on March 23, 2018

[2] Interagency Guidance on Leveraged Lending," released collectively on March 21, 2013, by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "**agencies**"), to update and replace the previously issued guidance by the agencies on sound practices for leveraged finance activities (referred to herein as the "**2013 Guidelines**"). Mr. Otting's remarks were made in a question and answer session that followed his speech at the SFIG Conference in Las Vegas on February 27, 2018.