



**SUBMITTED ELECTRONICALLY**

June 8, 2012

Office of the Comptroller of the Currency  
250 E Street S.W.  
Mail Stop 2-3  
Washington, DC 20219

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue N.W.  
Washington, DC 20551

Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street N.W.  
Washington, DC 20429

**Re: Proposed Guidance on Leveraged Lending**

Dear Sirs and Madams:

The Private Equity Growth Capital Council (the “PEGCC”) appreciates the opportunity to comment on the Proposed Guidance on Leveraged Lending (the “Proposed Guidance”) issued by the above-listed federal banking agencies (the “Agencies”).<sup>1</sup> The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007, and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The PEGCC members are 36 of the world’s leading private

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<sup>1</sup> 77 Fed. Reg. 19,417 (Mar. 30, 2012).

equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.<sup>2</sup>

The PEGCC agrees with the Agencies that leveraged finance activities, like other lending activities, benefit from sound risk-management practices, including well-documented credit decisions and active monitoring of borrower performance. The PEGCC also believes that lending institutions' leveraged finance risk-management practices must be permitted to vary in order to reflect individual institutions' leveraged portfolios, assets, earnings, liquidity, capital and experiences. To this end, the PEGCC is concerned that certain aspects of the Proposed Guidance are overly prescriptive and, contrary to the Agencies' assertion, inconsistent with industry norms and practices.

The PEGCC believes that, as discussed further below, the Agencies should avoid deploying artificial "bright-line" tests in any Final Guidance because such tests may not allow individual institutions to vary their approaches to reflect the facts and circumstances of a particular transaction or to accommodate differences among borrowers and industry sectors. Moreover, the PEGCC is concerned that, particularly over time, rigid tests may prove unworkable and counter-productive, as lenders rely on artificially established ratios and standards in lieu of the detailed credit analysis and careful risk-based judgments that the Agencies wish to promote.

For these reasons, the PEGCC strongly believes that industry participants must be permitted to adjust their leveraged lending practices to reflect borrower creditworthiness, market conditions and transaction details. Importantly, allowing such variations would not hinder the Agencies' ability to curb unsafe and unsound practices at particular institutions, which the Agencies have ample authority to address through the supervision and examinations process.

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<sup>2</sup> The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; CCMP Capital Advisors, LLC; Crestview Partners; The Edgewater Funds; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; TPG Capital (formerly Texas Pacific Group); Vector Capital; Vestar Capital Partners; and Welsh, Carson, Anderson & Stowe.

Definition of Leveraged Finance. The Proposed Guidance would require institutions involved in leveraged lending to adopt a definition of leveraged finance. The Agencies acknowledge that “numerous” definitions exist in the financial services industry. The Agencies offer that lending institutions may rely on a definition that includes some combination of four factors. One of those factors would rely on a 4X debt/EBITDA or 3X senior debt/EBDITA ratio, but the Agencies also suggest that “other defined levels appropriate to the industry or sector” may be used as appropriate. The Agencies do not identify the source for their 4X and 3X ratios.

The PEGCC believes that relying on any pre-defined debt/EBITDA ratios is inappropriate. Such an approach would not reflect variations in borrower risk profiles that are influenced by several variables, including variations in capital structures, volatility of cash flows and varied competitive dynamics across sectors and industries. Pre-established ratios therefore would lead to differently situated borrowers – in vastly different industries – being subject to the same risk-management approach, which seems a counter-productive use of lender resources.

For this reason, the PEGCC believes that the Agencies should not require institutions to incorporate a pre-established debt-to-EBITDA ratio in defining leveraged finance. The Agencies should instead allow institutions, as part of their risk-management frameworks, to establish definitions of leveraged lending that are appropriate for the industries, sectors and borrowers to which they lend.

Underwriting Standards. The Proposed Guidance would call on lending institutions to establish clear, written underwriting standards. The Agencies further specify that, at a minimum, underwriting standards should consider a “borrower’s capacity to repay and its ability to de-lever to a sustainable level over a reasonable period.”

The PEGCC concurs that borrower repayment and de-leveraging abilities are appropriate for consideration in underwriting standards, but the PEGCC disagrees with the Agencies’ follow-on statement that, “[a]s a general guide, base cash-flow projections should show the ability over a five-to-seven year period to fully amortize senior secured debt or repay at least 50 percent of total debt.” The PEGCC strongly believes that such a bright-line test, relying on specific percentages as a target for a set period of years, is inappropriate. Lenders, instead, should be encouraged to look to a variety of factors, including industry norms, that may affect a borrower’s ability to repay its obligations.

Covenants. In the Proposed Guidance, the Agencies discuss the need for credit agreements to include covenant protections. One particular covenant cited by the Proposed Guidance is that an entity’s leverage level after planned asset sales not exceed 6X total debt/EBITDA, which the Agencies suggest is an appropriate level for “most industries.”

Credit agreement covenants are highly negotiated and reflect considered judgments between sophisticated parties as to the allocation of the specific risks arising from the particular transaction. Moreover, an over-reliance on covenants can be highly problematic, as the result may be technical breaches and “foot faults” that create difficulties for both the lender(s) and borrower. Consequently, in Final Guidance, the Agencies should ensure that lending institutions have the discretion to rely on covenants that are appropriate and reflect the risks present in particular transactions.

The PEGCC also believes that the use of pre-set debt-to-EBITDA ratios is inappropriate in this context. Referencing a specific debt-to-EBITDA ratio does not account for variations across deals and markets. The Agencies seem to acknowledge this limitation, suggesting that the Proposed Guidance’s specific ratio is suitable for “most industries.” That standard is both overly vague and overly broad – which industries fall within the “most” and which fall outside? Such vague pronouncements by the Agencies may result in lenders relying on a 6X debt/EBITDA standard across-the-board, even when different ratios are necessary and warranted and even though the Agencies offer no rationale for the 6X standard. The PEGCC urges the Agencies to remove from Final Guidance any reference to a pre-set ratio of debt/EBITDA.

Deal Sponsors. The Proposed Guidance would require lending institutions to formulate guidelines that evaluate the qualifications of financial sponsors and implement a process to monitor performance. The Agencies go on to note that lenders “may consider support from a sponsor in assigning an internal risk rating.” The Agencies state that evaluation of a sponsor’s financial support should include a number of specific items.

The PEGCC concurs that lenders should be permitted – but not required – to consider sponsor support. The PEGCC does not believe that the Agencies’ Proposed Guidance suggests differently, but the PEGCC recommends that the Agencies clarify this point in Final Guidance.

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In sum, the PEGCC supports sound risk-management practices among leveraged finance lenders, but it strongly believes that the Agencies should ensure that lending firms are able to adopt sound standards that reflect individual risk-based analyses. To this end, the PEGCC asks the Agencies to ensure that the Final Guidance does not include artificial, bright-line tests that may discourage individualized judgments and careful credit analysis.

The PEGCC appreciates the Agencies' consideration of this letter and is available to discuss any questions that the Agencies may have.

Respectfully submitted,

A handwritten signature in blue ink that reads "Steve Judge". The signature is fluid and cursive, with the first name "Steve" and last name "Judge" clearly distinguishable.

Steve Judge  
President and CEO  
Private Equity Growth Capital Council