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GAO Determines Leveraged Lending Guidance is a "Rule" under Congressional Review Act

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On October 19, 2017, the Government Accountability Office ("GAO") determined that the Interagency Leveraged Lending Guidance ("LLG")[1] issued by three federal banking agencies, the Board of Governors of the Federal Reserve System ("FRB"), Federal Deposit Insurance Corporation ("FDIC") and Office of the Comptroller of the Currency ("OCC") (collectively, the "Agencies"), is a "rule" for purposes of the Congressional Review Act ("CRA").[2] In effect, this gives Congress the right to review the LLG and, pursuant to such review, issue a joint resolution to disapprove it.

Perhaps more important, according to the terms of the CRA, a rule must be submitted by the promulgating agency(ies) to Congress for Congressional review before the rule can take effect,[3] suggesting a lack of regulatory authority where that process has not been followed as is the case for the LLG. However, the CRA appears to contradict itself in this regard by noting that "any rule that takes effect and later is made of no force or effect by enactment of a joint resolution [of Congress] shall be treated as though such rule had never taken effect."[4] In practice, it appears the latter approach may be the one favored. The Congressional Research Service specifically addresses this approach, noting that *if a rule has already taken effect*, the rule shall not continue in effect[5] and "shall be treated as though such rule had never taken effect,"[6] i.e., if the rule is disapproved by a joint resolution of Congress that is signed by the President.

This calls into question how the Agencies will choose to treat the LLG should Congress not take any action to review and disapprove it, as well as the potential implications for banks if Congress does or does not disapprove the LLG. Complicating the picture is the possibility of retroactive effect if the LLG is disapproved (and, arguably, even if it is not under one reading of the CRA), as well as uncertainty about how the Agencies will proceed/respond under various scenarios, as discussed below.

While the obvious conclusion would appear to be the LLG remains in effect if Congress does not act within its 60-day review period to disapprove the LLG, an equally defensible view under the CRA appears to be, because the LLG is a rule under the CRA and the Agencies did not submit it to Congress, it cannot have taken effect. Further complicating this picture is an ambiguous and confusing CRA provision regarding a restriction on judicial review.[7]

The Agencies issued the LLG in the form of "interagency guidance" in 2013. The LLG establishes the Agencies' expectations for sound risk management of bank leveraged lending activities, including clear, written and measureable underwriting standards, based, among other things, on the premise that a borrower's leverage ratio in excess of six times total debt-to-EDITDA[8] raises concerns for most industries. The LLG was intended to provide greater clarity regarding the Agencies' supervisory expectations regarding the leveraged lending exposure of regulated banks.

The GAO determination ("GAO Determination") makes the LLG's continued application uncertain. At a minimum, the GAO Determination paves the way for Congress to disapprove the LLG, rendering it to have no force or effect. As noted above, however, the literal terms of the CRA suggest that the LLG cannot take effect until the Agencies submit it to Congress. Moreover, Congress' joint resolution disapproving the LLG would mean that the LLG would not continue in effect *and would result in the LLG being treated as if it had never taken effect*.[9] Until then or absent such eventuality, it appears the Agencies may continue to apply the LLG standards to monitor and assess the classification and corresponding regulatory capital treatment of syndicated and other leveraged loans. To date, the Agencies have not said publicly if or how they will address the GAO Determination.

Basis of the GAO Determination

The GAO Determination was issued in response to a request from Senator Pat Toomey regarding whether the LLG is a "rule" for purposes of the CRA. As noted above, the CRA establishes Congress' right to conduct a one-time review of rules promulgated by the Agencies to determine if they should be disapproved. According to its sponsors, the CRA was intended to provide a Congressional "review mechanism" to help restore the "delicate balance between the appropriate roles of the Congress in enacting laws and the Executive Branch in implementing those laws."[10]

When submitting a rule to Congress pursuant to the CRA, the CRA requires that the agency(ies) promulgating the rule must include a concise statement and indication of whether it is a "major rule" (i.e., has resulted in or is likely to result in significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of US-based enterprises to compete with foreign-based enterprises in domestic and export markets).[11] The submission requirement covers the final version of most rules that have already been subject to public notice and comment. Submission of a final rule pursuant to the CRA starts a 60-day review period in which Congress must determine whether such rule should be disapproved.[12]

While the Agencies published both the proposed and final LLG for notice and public comment in the Federal Register, the Agencies did not submit the final LLG to Congress pursuant to the CRA.

A rule for CRA purposes is "an agency statement of general or particular applicability and future effect designed to implement, interpret or prescribe law or policy."[13] In an effort to distinguish the LLG from a rulemaking, the Agencies referenced it as a "general statement of policy." The Agencies further stated that the LLG did not fit within the CRA definition of a "rule" as the LLG was limited to explaining how the Agencies will exercise enforcement authority in the future as opposed to establishing a set of legally binding standards.[14]

In connection with its review of the request from Senator Toomey, the GAO agreed that the LLG is a general statement of policy, but qualified it as a "statement of general applicability and future effect designed to implement, interpret or prescribe law or policy," which the GAO previously opined is a rule for CRA purposes.[15] The GAO concluded that, as a "general statement of policy designed to assist financial institutions in providing leveraged lending to creditworthy borrowers in a sound manner," the LLG is a rule under the CRA.[16]

Congressional Review of the CRA

The determination that the LLG is a "rule" under the CRA enables Congress to disapprove the LLG by a joint resolution of both Houses, unless vetoed by the President. By the same token, Congress could elect not to disapprove, which would only require one House of Congress to not support a joint resolution disapproving the LLG. And the President could elect not to sign a joint resolution.

In general, Congress has a limited 60-day window to disapprove any rule submitted to it pursuant to the CRA. This window starts from the later of the day Congress receives the rule from the promulgating agency(ies) or it is published in the Federal Register.[17] While the Agencies may or may not submit the LLG to Congress, Congress may still be authorized to take action on the LLG. In other GAO determinations that existing guidance is a rule, Congress has taken the view that the CRA window for disapproving the rule opens on the date that the official GAO determination that the guidance is a rule is published in the Congressional Record.[18]

Senator Toomey has indicated his intention to "explore steps" to hold the Agencies accountable to "live up to their obligations" under the CRA.[19]

The GAO has made prior determinations that guidance or other issuances are rules in at least 11 prior instances.[20] Seven of those resulted in a rule finding similar to the GAO Determination for the LLG. Notably, none of those led to a joint resolution of Congress disapproving the guidance/rule. It is unclear whether that record will remain intact with Congressional review, if any, of the LLG.

Prior to the current Congress, Congress is reported to have used the CRA only once—in 2001—to successfully "roll back" an existing rulemaking.[21] Earlier this year, Congress exercised its authority under the CRA to vote to repeal over a dozen rules promulgated at the end of the Obama Administration that ranged from rules governing methane emissions to permitted hunting in Alaskan wildlife refuges.[22] Most recently, Congress passed a joint resolution disapproving the so-called arbitration rule promulgated by the Consumer Financial Protection Bureau earlier this year.[23]

Potential Implications for Banks

If the LLG is disapproved, the Agencies—in bank examinations and reviews of syndicated loans under the Shared National Credit ("SNC") Program—would not be able to cite a loan participation or syndication as not complying with the LLG. *However*, the Agencies would retain broad statutory "safety and soundness" authority to cite a loan as highly leveraged and/or take enforcement action against a banking organization for its participation in highly leveraged lending.

A Congressional resolution declaring the LLG disapproved could result in SNC reviews that rely to a lesser extent on whether a loan represents over 6.0X leverage for the borrower with the result that not all or fewer loans with a 6.0X or higher leverage ratio will be required to be treated as classified loans requiring banks to hold more capital against such loans. The Agencies, however, would retain their statutory authority to determine a loan to be unsafe or unsound or to constitute an unsafe or unsound banking practice by a lender.

If disapproved, the CRA provides that the LLG should be treated as though it had never taken effect.[24] This could draw into question any supervisory findings of the Agencies, such as examination determinations and any SNC determinations relying on the LLG standard. However, it is not clear whether banks and others affected by such findings or determinations would have a cause of action as a result of adverse findings based on the LLG. And it does appear that any Congressional determination to disapprove the LLG would not be subject to judicial review.[25] In this regard, Congress' right to review a rule applies notwithstanding any other provision of law, and any Congressional resolution disapproving a rule may not be appealed to a court of law.[26]

Potential Responses of the Agencies

The LLG replaced prior guidance issued by the Agencies in 2001 establishing safe and sound practices for leveraged lending that included the Agencies' expectations on well-defined underwriting standards. The 2001 guidance did not set a quantified leverage limit, only an expectation of "reasonable amortization of term loans" over a moderate period. Because the LLG replaced the 2001 guidance, the 2001 guidance would not become the resulting guidance if the LLG is disapproved.

The Agencies could decide jointly or individually to issue new guidance on leveraged lending. Given the GAO determination, the Agencies would likely treat any such "guidance" as a proposed rule that would be submitted for public comment. As noted above, the LLG was also submitted for public comment, but it was not submitted to Congress after it was adopted. Any new "guidance" issued by the Agencies that is not submitted to Congress would almost certainly face the prospect of being deemed a "rule" and the potential for CRA review and Congressional disapproval of such guidance, as with the LLG.

To date, the Agencies have not responded formally to the GAO Determination and have not indicated an intention to amend, change or reissue the LLG. Thus, it is unclear how the CRA process will unfold.

If Congress disapproves the LLG by a joint resolution, the Agencies would not be permitted to issue a new rule that is "substantially the same" as the LLG.[27] While the CRA does not define "substantially the same," FAQs issued by the Congressional Research Service suggest that sameness should be determined based on the scope, penalty level, textual similarity and administrative policy, among other factors.[28]

If the LLG is not disapproved by Congress, the Agencies might determine to replace the LLG with a revised version that would be subject to public comment as a rulemaking and that when adopted would be submitted to Congress. If Congress does take up review of the LLG based on its practice in prior instances of reviewing guidance and other issuances upon receiving a GAO determination, rather than upon receiving the rule from the promulgating agency as provided in the CRA, the Agencies might decide that Congress' failure to disapprove the rule renders the LLG a valid rule, notwithstanding the CRA requirement that "before a rule can take effect" the Agencies must submit it to Congress.

If the Agencies were to seek to craft guidance in the face of the LLG being disapproved, they also could look to one or more of the following for further input or guidance:

- A staff report issued by the Federal Reserve Bank of New York on the efficacy of the LLG as a macroprudential policy tool concluded that, while the LLG "was effective at reducing leveraged lending activity among banks," in particular banks subject to supervision by the FRB's Large Institution Supervision Coordinating Committee, which were the main originators of leveraged loans, such reduction "did not lead to a commensurate reduction of risk in the banking sector because some of the leveraged lending business migrated to nonbanks which in turn resorted to banks to raise funding for this activity."[29] The report finds that the migration to nonbanks makes it less clear that the LLG accomplished the stated objective of reducing the risk that leveraged loans pose to US financial stability. Members of Congress might look to the LLG's stated objective of financial stability to bolster a finding that the LLC is a "major rule" for purposes of the CRA.

- The SNC Program Review Report ("SNC Report"), covering the third quarter of 2016 and the first quarter of 2017, noted that "agent banks are now better equipped to project future cash flows to assess repayment capacity and enterprise valuations' as a result of the underwriting and risk management processes implemented in response to the LLG and found such practices to "better align with basic safety and soundness principles."[30] The SNC Report did not mention the LLG's financial stability objective. The Agencies, however, did note their concern "that any downturn in the economy would result in significant increase in the already considerable adversely risk rated leveraged lending exposure." While noting "continued incremental easing in underwriting standards as a concern, the National Risk Committee of the OCC, in its Semiannual Risk Perspective for Fall 2016 issued in January 2017, downgraded the characterization of leveraged lending from a key risk to an issue warranting continued monitoring.[31]

- The Agencies also may look to the current Administration's recommendations on leveraged lending. In its June 2017 report on financial reform for banks, the Treasury Department recommended the following changes to the LLG "to maximize the role that leveraged lending plays in the provision of capital to business:"[32]
    - The LLG should be re-issued for public comment;
    - The LLG should be "refined with the objective of reducing ambiguity in the definition of leveraged lending and achieving consistency in supervision, examination and enforcement"; and
    - "Banks should be encouraged to incorporate a *clear but robust set of metrics* when underwriting a leveraged loan, instead of solely relying on a 6x leverage ratio."

Concluding Observations

While it is clear that the GAO Determination gives Congress the right to review the LLG and, pursuant to such review, disapprove it, less clear are the potential implications of the GAO Determination, including application of the LLG since it was promulgated by the Agencies. While the CRA itself creates this ambiguity, what is not ambiguous is the impact on the LLG if Congress moves via a joint resolution to disapprove it, and the President signs such resolution. As noted above, the CRA specifies that if a rule has already taken effect, the rule shall not continue in effect and "shall be treated as though such rule had never taken effect." In this event, there are significant potential supervisory, regulatory and legal implications that will have to be considered by the Agencies, Congress and institutions impacted by the LLG.

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[1] Interagency Guidance on Leveraged Lending (March 21, 2013), available at https://www.federalreserve.gov/supervisionreg/srletters/sr1303a1.pdf.

[2] GAO Letter to Sen. Pat Toomey ("GAO Determination"), 163 Cong. Rec. S6636 (Oct. 19, 2017), available at https://www.congress.gov/crec/2017/10/19/CREC-2017-10-19-pt1-PgS6636-2.pdf.

[3] 5 U.S.C. § 801(a)(1)(A).

[4] 5 U.S.C. § 801(a)(1)(F).

[5] Citing 5 U.S.C. § 801(b)(1).

[6] Congressional Research Service, The Congressional Review Act: Frequently Asked Questions, No.7-5700 (Nov. 17. 2016); citing 5 U.S.C. § 801(f).

[7] 5 USC § 805.

[8] EBITDA refers to "earnings before interest, tax, depreciation and amortization."

[9] *See supra*, note 6.

[10] Statement for the Record of Senators Nickles, Reid and Stevens, 142 Cong. Rec. S3683 (Apr. 18. 1996), available at https://www.congress.gov/crec/1996/04/18/CREC-1996-04-18.pdf.

[11] 5 USC § 801(a)(1).

[12] 5 USC §§ 801(a)(3)(A) and (d).

[13] 5 USC § 804(3).

[14] GAO Determination at 3 – 4.

[15] GAO Letter to Sen. Orrin Hatch (Sep. 4, 2012), available at http://www.gao.gov/assets/650/647778.pdf.

[16] GAO Letter to Sen. Pat Toomey (Oct. 19, 2017), available at https://www.gao.gov/assets/690/687879.pdf.

[17] 5 USC §802(a).

[18] Congressional Research Service, The Congressional Review Act: Frequently Asked Questions (Nov. 17. 2016) ("CRA FAQs") at 12, available at https://fas.org/sgp/crs/misc/R43992.pdf.

[19] GAO Agrees with Toomey: Lending Rule Subject to Congressional Review (Oct. 19, 2017), available at https://www.toomey.senate.gov/?p=news&id=2016.

[20] CRA FAQs, supra, at 12.

[21] *Congressional Review Act Gets a Workout* (May 15, 2017), available at https://www.rollcall.com/news/politics/congressional-review-act-gets-a-workout.

[22] *Id.*

[23] H.J. Res. 111 (115th Cong. Oct. 25, 2017).

[24] 5 USC § 801(f).

[25] 5 USC § 805. While there is some ambiguity regarding the extent of judicial review permissible under the CRA, it does appear that there is general agreement on the lack of ability of the courts to review Congressional action under the CRA. *See* Congressional Research Service, CRA FAQs at 18, available at https://fas.org/sgp/crs/misc/R43992.pdf.

[26] 5 USC §§ 805 and 806.

[27] 5 USC § 801(b)(2).

[28] Congressional Research Service, CRA FAQs at 16, available at https://fas.org/sgp/crs/misc/R43992.pdf.

[29] Staff Report of Federal Reserve Bank of New York, *Macroprudential Policy and the Revolving Door of Risk: Lessons from Leveraged Lending Guidance* (May 2017), available at https://f.datasrvr.com/fr1/417/58150/sr815.pdf.

[30] SNC Program Report (Aug. 2017) at 3, available at https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-ia-2017-90a.pdf.

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[32] Treasury Department, A Financial System that Creates Economic Opportunities: Banks and Credit Unions (Jun. 2017), available at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.