United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

April 11, 2019

Hon. Steven T. Mnuchin
Chair
Financial Stability Oversight Council
U.S. Department of the Treasury
1500 Pennsylvania Ave. N.W.
Washington, D.C. 20220

Dear Chair Mnuchin:

I write with growing concern about the risks in the leveraged loan market. Financial experts and news reports since last year have continued to raise alarms.[1] Regulators are aware of the risks, yet the Financial Stability Oversight Council (FSOC or Council) and its members have failed to take any decisive action to address these concerns.[2] In fact, the member agencies have moved in the wrong direction by downplaying the significance of 2013 agency guidance meant to address risks in leveraged lending.[3]

Instead, the Council is focused on deregulating the financial services industry rather than performing its mission of identifying risks and responding to emerging threats to financial stability. In FSOC's 2018 Annual Report to Congress you highlighted a number of safety and soundness standards that the Council agencies amended during the previous year, including rescinding the last systemically important non-bank designation, weakening the Volcker rule that prevents banks from gambling with taxpayer-guaranteed deposits, and reducing capital requirements and stress testing at some of the largest banks in the country.[4] While the 2018 FSOC report briefly discusses leveraged lending, the Council recommended only a wait and see approach.[5]

By contrast, international regulators have raised concern that poor underwriting standards, rapid growth, and increased risk-taking in the leveraged loan market mirrors subprime mortgage

---

[1] See: https://www.ft.com/content/04352e76-d792-11e8-a854-33d6f82e62f8 and https://www.washingtonpost.com/business/economy/how-regulators-republicans-and-big-banks-fought-for-a-big-increase-in-lucrative-but-risky-corporate-loans/2019/04/06/08c8cd58-4b1e-11e9-b79a-961983b7e0cd_story.html
[2] "SEC Chief Raises Concerns About Risky Lending," https://www.wsj.com/articles/sec-chief-raises-concerns-about-risky-lending-11554739726; Joint Release, "Shared National Credit Review Finds Some Improvement in Credit Quality, Risk Remains Elevated in Leveraged Loans," https://occ.gov/news-issuances/news-releases/2019/nr-ia-2019-8.html
[3] https://www.reuters.com/article/us-usa-banks-guidance/us-bank-regulators-say-supervisory-guidance-has-no-legal-weight-idUSKCN1LR2F1
[4] FSOC 2018 Report to Congress, https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf
[5] Ibid. pp. 11, 25-26, 112.

lending and might have far-reaching economic consequences.[6] Former Federal Reserve Chair Janet Yellen recently raised similar concerns about the impact of increased leverage in an economic downturn.[7]

The marked increase in the volume of leveraged loans originated by financial institutions has been accompanied by a notable decrease in underwriting standards. Like many financial activities, leveraged lending benefits banks and financial intermediaries that profit by packaging and selling risky loans. As we learned in the run-up to the financial crisis of 2008, the health of the economy can't be judged by the short-term profitability of Wall Street. Remember, when Citigroup CEO Chuck Prince was asked in 2007 whether he was worried about the risks in his bank's leveraged lending portfolio, he said: "as long as the music is playing, you've got to get up and dance. We're still dancing."[8] As was true of that crisis, when poorly underwritten loans go bad, it is not the banks or even the investors that take the brunt of the pain – it's hardworking families and local communities.[9]

FSOC must consider whether this additional risk to the banking system serves as a public benefit to the real economy. For example, leveraged loans are often used to fund risky private equity transactions, many of which struggle and fail under unsustainable debt loads, causing harm to local and regional economies. These types of transactions can cause booms and busts that harm workers and the environment,[10] facilitate the concentration or even dissolution of important democratic institutions like local newspapers,[11] make housing less accessible and more costly,[12] or even undermine the provision of the most basic and critical government services.[13]

In short, an overheated leveraged lending market rewards bad investments that will have negative repercussions for the workers and businesses that create economic growth.

While this administration has bragged about the stock market, household debt has grown to record highs,[14] student loan delinquencies have accelerated,[15] and more Americans are falling behind on their car payments.[16] Families across the country are struggling and can't afford to be squeezed any harder. We must pay attention to the workers on Main Street who drive our economy and make sure speculation and greed on Wall Street do not cause another financial crisis.

---

6 https://www.reuters.com/article/us-boe-loans-carney/leveraged-loans-echo-pre-crisis-subprime-crash-boes-carney-idUSKCN1PA1SX
7 https://www.reuters.com/article/regulatory-crackdown-unlikely-in-us-leve/regulatory-crackdown-unlikely-in-us-leveraged-loan-market-idUSL1N2120Q6
8 https://www.reuters.com/article/us-citigroup-lbo/citigroups-lbo-dance-card-proves-too-full-idUSN0132320120071003
9 https://www.reuters.com/article/regulatory-crackdown-unlikely-in-us-leve/regulatory-crackdown-unlikely-in-us-leveraged-loan-market-idUSL1N2120Q6
10 https://www.wsj.com/articles/from-2-billion-to-zero-a-private-equity-fund-goes-bust-in-the-oil-patch-1500210002
11 https://prospect.org/article/saving-free-press-private-equity;
12 https://www.theatlantic.com/technology/archive/2019/02/single-family-landlords-wall-street/582394/
13 https://www.nytimes.com/interactive/2016/08/02/business/dealbook/this-is-your-life-private-equity.html
14 https://www.newyorkfed.org/newsevents/news/research/2019/20190212
15 https://www.bloomberg.com/news/articles/2019-02-22/u-s-student-loan-delinquencies-hit-record
16 https://www.bloomberg.com/news/articles/2019-02-12/auto-loan-performance-worsens-on-rise-in-subprime-delinquencies

The Council should not wait to see what happens when the music stops. Regulators must demonstrate that they are responding to threats to financial stability before the real economy suffers. To that end, please provide me the following no later than April 23, 2019:

1) Any analyses of the leveraged lending market that the Council and its member agencies have performed in the last two years;
2) Any other Council documents discussing the risks of leveraged lending and staff recommendations to address those risks;
3) A list of all Council meetings where leveraged lending was discussed, including the dates of those meetings, attendees, and materials presented;
4) A list of supervisory or other actions that the Council and its member agencies have taken at regulated institutions in order to address risks in the leveraged lending market, especially with regard to weak underwriting standards; and
5) A description of how FSOC is monitoring leveraged lending markets and what actions it plans to take to protect the economy from threats in credit and lending markets.

Sincerely,

Sherrod Brown

Sherrod Brown
Ranking Member

cc: Hon. Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System
Hon. Joseph Otting, Comptroller, Office of the Comptroller of the Currency
Hon. Kathleen Kraninger, Director, Consumer Financial Protection Bureau
Hon. Jay Clayton, Chair, Securities and Exchange Commission
Hon. Jelena McWilliams, Chair, Federal Deposit Insurance Corporation
Hon. J. Christopher Giancarlo, Chair, Commodity Futures Trading Commission
Hon. Rodney Hood, Chair, National Credit Union Administration
Hon. Thomas E. Workman, Independent Member Having Insurance Expertise, Financial Stability Oversight Council
Hon. Mark Calabria, Director, Federal Housing Finance Agency
Ken Phelan, Acting Director, Office of Financial Research
Steven Seitz, Director, Federal Insurance Office
Charles G. Cooper, Commissioner, Texas Department of Banking
Eric Cioppa, Superintendent, Maine Bureau of Insurance
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General