



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

April 30, 2019

The Honorable Sherrod Brown  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate  
Washington, DC 20510

Dear Senator Brown:

I write in response to your April 11, 2019 letter regarding the Financial Stability Oversight Council's (Council) monitoring of risks in the leveraged loan market.

The Council annually provides Congress with a report that identifies potential emerging threats to U.S. financial stability. The Council's 2018 annual report—unanimously adopted by the Council on December 19, 2018—did just that, evaluating developments in corporate borrowing and corporate credit markets. The analyses in the report included trends in nonfinancial corporate debt relative to the size of the U.S. economy; nonfinancial business leverage and interest coverage ratios; nonfinancial corporate liquid assets; corporate credit spreads; and issuance of corporate bonds and collateralized loan obligations.<sup>1</sup>

The Council determined that while U.S. nonfinancial businesses have continued to service their debt burdens with low delinquency rates due to their strong interest coverage and liquidity positions, these factors may not prevent increased defaults in the event of a recession or other shock to business earnings. The Council concluded that the potential impact on financial stability would depend on the extent and severity of business defaults, the extent of spillovers to other markets, and the ability of investors and intermediaries to manage their losses.<sup>2</sup>

As referenced in your letter, the 2018 annual report further included a recommendation that agencies continue to monitor levels of nonfinancial business leverage, trends in asset valuations, and potential implications for the entities they regulate in order to assess and reinforce their ability to manage severe, simultaneous losses in those markets. The Council noted that actions to ensure that the relevant investors and intermediaries can manage such losses, rather than amplify or transmit them, will reduce the threat to financial stability posed by such a scenario.<sup>3</sup>

The Council continues to monitor developments in nonfinancial corporate credit. Most recently, at its meeting on March 6, 2019, the Council received a presentation from staff of the Board of

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<sup>1</sup> See Fin. Stability Oversight Council, 2018 Annual Report, at 25-27, <https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf>.

<sup>2</sup> See *id.* at 112.

<sup>3</sup> See *id.* at 11.

Governors of the Federal Reserve System (Federal Reserve) and the Office of Financial Research. Council members discussed trends in credit quality and outstanding debt volumes, as well as potential vulnerabilities.

Individual Council member agencies with supervisory or other responsibilities also are continuing to monitor the potential effects of developments in the leveraged lending market on their respective regulated entities. For example, the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency review and assess risk in leveraged lending, among other lending types, through their Shared National Credit (SNC) Program. In their 2018 SNC Program Review, the federal banking agencies found that risks associated with leveraged lending activities were building. They stated, among other things, that banks engaged in originating and participating in leveraged loans should ensure that risk-management processes keep pace with changes in the leveraged lending market and ensure that their risk-management processes and limits fully consider the potential direct and indirect risks associated with these loans.<sup>4</sup> I respectfully refer you to those regulators for additional information on their activities in this area.

If you have any other questions, please direct your staff to contact the Office of Legislative Affairs.

Sincerely,



Frederick W. Vaughan  
Deputy Assistant Secretary  
Office of Legislative Affairs

cc: The Honorable Jerome H. Powell  
The Honorable Joseph M. Otting  
The Honorable Kathleen Kraninger  
The Honorable Jay Clayton  
The Honorable Jelena McWilliams  
The Honorable J. Christopher Giancarlo  
The Honorable Rodney Hood  
The Honorable Thomas E. Workman  
The Honorable Mark Calabria  
Director Steven Seitz  
Commissioner Charles G. Cooper  
Superintendent Eric Cioppa  
Securities Commissioner Melanie Lubin

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<sup>4</sup> Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., & Office of the Comptroller of the Currency, Shared Nat'l Credit Program, 1st and 3rd Quarter 2018 Examinations, at 3 (Jan. 2019), <https://www.occ.treas.gov/news-issuances/news-releases/2019/pub-snc-review-2018.pdf>.