

March 19, 2020

The Honorable Steven T. Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Secretary Mnuchin:

I write to you in your capacity as Chair of the Financial Stability Oversight Council (FSOC) to request information about the leveraged lending market and the risks these loans pose to the financial system as global financial and economic conditions deteriorate amid the spread of coronavirus disease 2019 (COVID-19). FSOC is tasked with identifying and responding to these risks to financial stability.

Leveraged loans are loans made to companies that are already highly in debt.¹ These loans can be made by “banks, insurance companies, pension funds, mutual funds, hedge funds, and other private investment funds.”² When an institution originates a leveraged loan, it generally sells off all or part of the loan to investors, often by securitizing the loan through a structure known as a collateralized loan obligation (CLO). Over 60 percent of leveraged loans are held through CLOs,³ and these instruments have been a significant contributor to the more-than-doubling of this \$1.2 trillion loan market over the past decade.⁴

I previously wrote to you and other federal financial regulators about the risks associated with the rapid growth of these loans.⁵ Underwriting standards are poor, and there are few protections for lenders and investors.⁶ Moreover, similar to the subprime mortgage market prior to 2008, the securitization of these loans and the growth of CLOs has allowed the exposure and risks associated with this lending to spread throughout the economy to multiple investors and

¹Congressional Research Service, “Leveraged Lending and Collateralized Loan Obligations: Frequently Asked Questions,” Eva Su, Marc Labonte, and David Perkins, December 4, 2019, pp. 1, <https://crsreports.congress.gov/product/pdf/R/R46096>.

² *Id.*, pp. 2.

³ *Id.*, pp. 6.

⁴ Reuters, “Leveraged loan market size doubles in ten years, private credit explodes,” Michelle Sierra, December 23, 2019, <https://www.reuters.com/article/levloan-decade/leveraged-loan-market-size-doubles-in-ten-years-private-credit-explodes-idUSL1N28U0QQ>.

⁵ Letter from Senator Warren to Financial Regulators, November 14, 2018, <https://www.warren.senate.gov/imo/media/doc/2018.11.14%20Letter%20to%20Regulators%20on%20Leveraged%20Lending.pdf>.

⁶ *Id.*

industries.⁷ Now, as we are on the verge of another, potentially deeper, economic crisis, regulators still have not taken meaningful action to mitigate these risks.

In an economic downturn, these loans can present greater risks to the broader economy. If institutional borrowers are unable to repay their loan balances due to hits to their bottom lines, the loans will fail and spread risk to all the entities that are exposed to them, escalating the effects of an economic downturn across many more institutions and millions of already hard-hit families.⁸ As FSOC stated in its 2019 Annual Report, “high levels of nonfinancial business leverage could intensify the impact of a sharp reversal in business conditions and have spillover effects to other sectors of the economy.”⁹ A separate report issued jointly by the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency similarly found that the risks associated with banks’ exposure to leveraged lending “remain elevated,”¹⁰ that “lenders have fewer protections and risks have increased in leveraged loan terms,”¹¹ and that “a material downturn in the economy could result in a significant increase in classified exposures and higher losses.”¹²

The current stress in the financial sector has urgently increased the need for transparency in this market. In particular, loans that are expected to mature in the near future are particularly vulnerable to refinancing risk, putting the health of exposed companies and the workers they employ in jeopardy.¹³ As one analyst has noted, “even high credit quality leveraged loans ... could fall significantly ... as nervous investors try to sell enough assets to be liquid and to meet regulatory or economic capital requirements to withstand unexpected losses.”¹⁴ But there is little publicly available information about these loans and the risks they pose to the financial system.¹⁵

FSOC was created for the express purpose of monitoring this type of systemic risk and coordinating action among regulators. Given the fragile state of the economy, I ask that you answer the following questions by April 2, 2020 to provide transparency and clarification as to how FSOC is addressing risks associated with the leveraged lending market.

⁷ *Id.*

⁸ Bloomberg, “Coronavirus Exposes the Danger of Corporate America’s Debt Binge,” Rich Miller and Claire Boston, March 10, 2020, <https://www.bloomberg.com/news/articles/2020-03-10/coronavirus-exposes-the-danger-of-corporate-america-s-debt-binge>.

⁹ Financial Stability Oversight Council, “2019 Annual Report,” pp. 6, <https://home.treasury.gov/system/files/261/FSOC2019AnnualReport.pdf>.

¹⁰ Board Of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, “Shared National Credit Program 1st and 3rd Quarter 2019 Reviews,” January 2020, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200131a1.pdf>.

¹¹ Board Of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, “Shared National Credit Review Finds Risk Remains Elevated in Leveraged Loans,” January 31, 2020, <https://www.fdic.gov/news/news/press/2020/pr20007.html>.

¹² Board Of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, “Shared National Credit Program 1st and 3rd Quarter 2019 Reviews,” January 2020, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200131a1.pdf>.

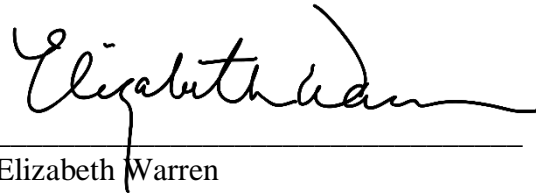
¹³ Forbes, “Significant Supervisory And Data Gaps Exist in Leveraged Loan And CLO Markets,” Mayra Rodriguez Valladares, December 19, 2019, <https://www.forbes.com/sites/mayrarodriguezvalladares/2019/12/19/significant-supervisory-and-data-gaps-exist-in-leveraged-loan-and-clo-markets/#706dbd14d274>.

¹⁴ *Id.*

¹⁵ *Id.*

1. Describe how FSOC is monitoring the risks associated with these loans, particularly with respect to the rapidly deteriorating economic conditions.
2. Provide FSOC's assessment of risks to the financial system and the economy as a whole related to these loans.
3. Provide FSOC's assessment of risks to individual industries that are exposed to these loans and how these industries could be impacted if these loans were to fail.
4. Does FSOC currently possess data on the volume and maturity dates of leveraged loan tranches across different institution types and industries? If so, please provide that disaggregated data for 2020 and each of the next ten years.

Sincerely,

A handwritten signature in black ink, appearing to read "Elizabeth Warren", written over a horizontal line.

Elizabeth Warren
United States Senator