



FEDERAL RESERVE BANK  
OF DALLAS

ROBERT D. McTEER, JR.  
PRESIDENT  
AND CHIEF EXECUTIVE OFFICER

February 28, 1992

DALLAS, TEXAS 75222

Notice 92-18

**TO:** The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

**SUBJECT**

**Discontinuance of the Supervisory Definition of Highly Leveraged Transactions**

**DETAILS**

The Federal Reserve Board has voted to discontinue use of the supervisory definition of highly leveraged transactions (HLTs) after June 30, 1992. The Board will also discontinue the reporting of HLT exposure by banking organizations it regulates after the June 30, 1992, reporting date.

In the interim, the Board has approved revisions to the supervisory definition of HLTs to be used by banks and bank holding companies for reporting their HLT exposure as of March 31, 1992, and June 30, 1992. Although the Board will phase out the use of the formal supervisory definition of HLTs, guidance previously issued by the Board for assessing individual credits that finance corporate restructurings and for evaluating internal processes for initiating and reviewing these credits will continue to be used by examiners for this purpose.

Because of the complex nature and level of risk associated with such HLT financings, boards of directors and management at banking organizations will be expected to continue to monitor carefully their banking organizations' risk exposure to these credits.

Similar action to discontinue use of the HLT definition and reporting has also been approved by the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

**ATTACHMENT**

A copy of the Board's notice as it appears on pages 5040-45, Vol. 57, No. 28, of the Federal Register dated February 11, 1992, is attached.

**MORE INFORMATION**

For more information, please contact Dan Kirkland at (214) 744-7433. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

*Robert D. McTeer, Jr.*

**DEPARTMENT OF THE TREASURY****Office of the Comptroller of the  
Currency**

[Docket No. 91-7]

**FEDERAL DEPOSIT INSURANCE  
CORPORATION**

[Docket No. 050984]

**FEDERAL RESERVE SYSTEM**

[Docket No. R-0734]

**The Supervisory Definition of Highly-  
Leveraged Transactions**

**AGENCIES:** Office of the Comptroller of the Currency, Treasury (OCC); Federal Deposit Insurance Corporation (FDIC); and Board of Governors of the Federal Reserve System (Board).

**ACTION:** Notice.

**SUMMARY:** The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System have approved: (1) The discontinuance, after June 30, 1992, of the supervisory definition of highly-leveraged transactions (HLT's); and (2) the discontinuance of the reporting of HLT exposure by banking organizations regulated by the agencies after the June 30, 1992 reporting date. In the interim, the agencies have approved revisions to the supervisory definition of HLT's to be used by banks and bank holding companies for reporting their HLT exposure as of March 31, 1992 and June 30, 1992.

Although the agencies will phase out the use of the formal supervisory definition, guidance previously issued by each agency for assessing individual credits that finance corporate restructurings and for evaluating internal processes for initiating and reviewing these credits will continue to be used by examiners for this purpose. Due to the complex nature and level of risk associated with such financings, boards of directors and management at banking organizations will be expected to continue to monitor carefully their

banking organization's risk exposure to these credits.

**DATES:** *Effective date.* February 11, 1992.

*Compliance dates.* The use of the supervisory definition of highly-leveraged transactions by the agencies will be discontinued effective after the June 30, 1992 financial reporting date for banking organizations regulated by the agencies. In the period preceding discontinuance of the definition, revisions to the definition have been approved for reporting HLT exposure as of March 31, 1992 and June 30, 1992.

**FOR FURTHER INFORMATION CONTACT:**

OCC: John W. Turner, National Bank Examiner, (202/874-5170), Chief's National Bank Examiner's Office.

FDIC: Garfield Gimber, Examination Specialist, (202/898-6913), Division of Supervision.

Board: Todd Glissman, Supervisory Financial Analyst (202/452-3953), or William Spaniel, Senior Financial Analyst (202/452-3469), Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunications Device for the Deaf ("TDD"), Dorothea Thompson (202/452-3544).

**SUPPLEMENTARY INFORMATION:** On July 10, 1991, the agencies published for comment the supervisory definition of highly-leveraged transactions (56 FR 31464, July 10, 1991). The agencies sought comment on all aspects of the HLT definition and criteria, as well as comments on specific issues raised by questions which the agencies had received. The comment period expired on September 26, 1991. The agencies received over 265 comments on the proposal.

After reviewing the status of the HLT definition, considering comments received from the public, and evaluating proposed revisions, the agencies have approved the phase out of the supervisory definition of HLT's and the discontinuance of reporting of HLT's after the June 30, 1992 financial reporting by banking organizations. The agencies have also approved revisions to the definition for use by banking organizations in reporting their HLT exposure as of March 30, 1992 and June 30, 1992.

The agencies, in approving the phase out of the supervisory definition of HLT's, have taken under consideration the public comments received on the HLT definition, the current status of HLT credits, the reduced level of merger and acquisition activity in recent months, and the reluctance of lenders, in some cases, to extend credit to sound borrowers. The agencies considered all options for maintaining or phasing out

supervisory oversight of highly-leveraged transactions. These included phasing out the definition, giving banks the flexibility to establish their own individual definitions, and proposing revisions to the supervisory definition.

While the agencies did not favor the immediate discontinuance of the definition, the agencies believe that the HLT definition has largely accomplished its purposes and have approved the phase out of the definition. The definition encouraged financial institutions to focus attention on the need for internal controls and review mechanisms to monitor these types of financing transactions. The definition also encouraged financial institutions to structure highly leveraged credits in a manner consistent with the risks involved. The HLT definition has played a role in helping the bank regulatory agencies identify these credits and monitor the risks associated with HLT portfolios over time. At the same time, the supervisory definition of highly-leveraged transactions was not intended to impart supervisory criticism.

With the phase out of the definition, the agencies' examiners will continue to evaluate, on an annual basis, those credits meeting the Shared National Credit Program criteria to assess the risk posed to insured depository institutions and holding companies by the individual credits, and such credits will be subject to supervisory criticism when appropriate. All other credits will be reviewed, as appropriate, through the normal examination process. Examiners will continue to thoroughly review each borrower's financial condition, income and cash flow; the value of any collateral or guarantees; the quality and continuity of the borrower's management; the borrower's ability to service its debt obligations; and other credit quality considerations. Consistent with sound banking practice, banking organizations will continue to be expected to have systems in place to monitor the risks associated with segments of their lending portfolios, including highly leveraged credits.

The agencies have adopted revisions to the definition to address concerns raised by the application and content of the definition. These revisions in the definition are to be used by banking organizations during the period preceding the discontinuance of the definition to report the level of their HLT exposure as of March 30, 1992 and June 30, 1992. These revisions include: (1) Allowing banking organizations to delist certain companies from HLT status that adequately service debt and clearly demonstrate superior cash flow,

relative to their respective industry or peer group; (2) reducing the timeframe in which a company's performance is evaluated before being delisted from HLT status; (3) delisting companies, previously designated as HLT's, emerging from Chapter 11 bankruptcy that are no longer highly leveraged; and (4) excluding certain loans from HLT reporting when fully collateralized by cash or cash equivalent securities.

#### Cash Flow Test

A cash flow test was not included in the original supervisory HLT definition or delisting criteria. Although delisting criteria state that cash flow coverage is to be taken into consideration when reviewing the overall performance of a borrower for delisting, a specific measure was not defined. The reason for not incorporating a specific cash flow test was because (1) the definition was implemented to provide a consistent means of aggregating and monitoring a type of financing transaction, thus relying heavily on a purpose test and an easily-calculated leverage test; (2) it was deemed problematic to develop a universal cash flow measure that could be used for all industries; and (3) there was a desire to avoid any impression that the definition implied a supervisory criticism of a credit, noting that cash flow is a primary factor in credit quality reviews.

The agencies, in publishing the supervisory definition of highly-leveraged transactions for comment, specifically sought comment on the appropriateness of the inclusion of a cash flow measure. A majority of comments from both companies and banks strongly favored the use of a cash flow test in the HLT definition, particularly for delisting purposes. Some favored a standardized cash flow test; others favored an industry-specific cash flow test; and some expressed a preference for both. Several banks stated, however, that it would be difficult to implement a cash flow measure for initially designating credits as HLTs because the analysis would have to be based on cash flow projections and not on historical performance.

In light of the comments received, the agencies reviewed potential cash flow measures including a debt service coverage ratio, an interest coverage ratio, and a ratio measuring the magnitude of debt in relationship to operating cash flow. All measures proved difficult to define adequately, particularly for use in analyzing companies in different industries. Moreover, it was found to be extremely difficult to establish a standardized

level of "acceptable" cash flow that could be applied to all industries.

The agencies concluded that it was not appropriate to adopt a standardized cash flow test; rather, the agencies believe that banking organizations should analyze pertinent cash flow ratios for individual HLT companies, then make a determination as to the quality and strength of each company's cash flow performance, subject to examiner review. Under the revision approved by the agencies, the credits of a highly leveraged company could be considered eligible for delisting by banking organizations on a case-by-case basis, if the company demonstrates superior cash flow coverage, relative to the company's industry or peer group, and the company has adequately serviced debt for a reasonable period of time since its last buyout, acquisition or leveraged recapitalization.

#### Reduce Timeframes for Delisting

Presently, a borrower designated as an HLT must show good performance for a minimum of two years from the date of the transaction before being eligible for delisting from HLT status.

After two years, if leverage<sup>1</sup> has been reduced below 75 percent, a borrower becomes eligible for delisting. If a borrower remains highly leveraged, however, the borrower must demonstrate performance for a period of up to four years before being eligible to be delisted from HLT status.

Upon considering the comments received, the agencies have determined that the delisting criteria should be amended by:

(a) Reducing the delisting timeframe from two years to one year for companies that deleverage below 75 percent or were designated as HLTs under the "doubling of liabilities to greater than 50 percent" leverage test. Under this standard, companies would have to continue to meet general performance criteria to be delisted.

(b) Reducing the delisting timeframe from four years to three years for companies that remain highly leveraged. A company would have to demonstrate performance for three consecutive years since its last highly-leveraged transaction and have a positive net worth in order to be eligible for delisting. The requirement that a company's leverage ratio not significantly exceed its industry norm in

<sup>1</sup> The leverage ratio is defined as total liabilities divided by total assets as reflected on financial statements prepared in accordance with generally accepted accounting principles (GAAP).

order to be delisted would be eliminated.

The agencies believe that allowing companies that deleverage themselves to be delisted sooner from HLT status should encourage companies to improve their capitalization and credit standing by reducing leverage and issuing additional equity. These substantive changes to HLT delisting criteria are expected to allow a significant number of companies to be removed from HLT status, given the number of companies recently issuing equity and the number of HLTs that have now aged beyond three years.

#### Delist Certain Companies Emerging From Chapter 11 Bankruptcy

In previous guidance, post-reorganization debt (after a company emerges from Chapter 11 bankruptcy) of a company that was designated HLT prior to bankruptcy proceedings retained an HLT designation until the company became eligible for delisting. Although a company was often deleveraged as a result of the reorganization, the company could not be delisted for at least two years from the date it was designated as an HLT.

Several comments stated that a company should not be designated HLT upon emerging from Chapter 11 reorganization if leverage is below 75 percent. It was indicated that continuing the HLT designation could interfere with these companies' ability to obtain post-reorganization financing. The agencies recognize that the purpose of Chapter 11 of the bankruptcy code is to help reorganize companies pursuant to a court-approved plan. Further, many reorganized companies emerging from bankruptcy are no longer highly leveraged and are, in essence, operating with a new balance sheet.

Reflecting these views, the Congress in the recently passed banking legislation "Federal Deposit Insurance Corporation Improvement Act of 1991" (section 474) amended the Federal Deposit Insurance Act to prohibit a federal banking agency from designating by regulation or otherwise a corporation as a highly-leveraged transaction (HLT) solely because such corporation is or has been a debtor or bankrupt under Title 11, if after confirmation of reorganization, such corporation would not otherwise be highly leveraged. In implementing the Congressional intent underlying this amendment, the agencies believe that this should serve to emphasize the role played by the bankruptcy code and remove any implied hindrance to this type of lending.

### Exclude Certain Fully Collateralized Loans from HLT Status

Comments were received on the inclusion of certain loans fully-collateralized by cash or cash equivalent securities in an HLT company's aggregate HLT exposure. It was indicated that the purpose of these fully-collateralized loans is generally not to take on additional debt for acquisition or restructuring purposes. It was also noted that a company arranging such a loan had sufficient liquid resources available on its balance sheet and, therefore, would not have needed to borrow such funds. Given these reasons, the agencies have found it appropriate to exclude certain fully-collateralized loans from HLT reporting by banking organizations.

### Other comments

Comment letters expressed support for several additional revisions to the HLT definition that the agencies have decided not to adopt at this time. Potential revisions that were not adopted include (1) exempting companies with investment-grade senior debt from HLT designation and (2) excluding debt of certain subsidiaries from a consolidated company's HLT designation.

Under HLT guidelines, it is possible for a company with investment-grade senior debt to be designated an HLT if the company has been involved in significant merger and acquisition activity and has very high leverage. Comment letters indicated, however, that very few such companies exist.

To date, investment-grade companies have not been exempted from the HLT definition because of a desire to (1) avoid including credit quality criteria in the definition; (2) avoid inequitable treatment for companies that may meet investment grade criteria but are too small to be evaluated by the major rating agencies; and (3) avoid dependence on outside credit rating agencies, noting that credit quality of a company can quickly deteriorate under the burden of heavy debt.

Based on comment letters received, the agencies have determined that exempting companies with investment-grade senior debt from HLT designation would appear to have little impact on the number of companies designated as HLTs, but it would serve to reinforce the perception that an HLT designation conveys credit quality information or criticism. Some comments noted that financial institutions could publicly disclose the level of investment-grade companies in their HLT portfolios, thus mitigating criticism by analysts of this

portion of their portfolios. Given that exempting investment-grade companies from HLT designation could further reinforce negative perceptions concerning the overall credit quality of HLT loan portfolios, the agencies decided not to adopt such a change.

Comments were received on the inclusion of the debt of subsidiaries as part of the aggregate HLT exposure. According to the HLT guidelines, if a company satisfies the HLT purpose and leverage tests on a consolidated basis, then a loan to any part of the organization is designated HLT. Also, if a subsidiary satisfies the HLT criteria and its debt level is significant enough to cause the consolidated organization to meet HLT leverage criteria, then all debt of the entire organization is designated HLT.

The review of financial statements and calculation of the leverage ratio for HLT purposes is conducted using generally accepted accounting principles (GAAP). Analyzing companies on a consolidated basis when determining HLT status is considered consistent with GAAP. Moreover, experience with consolidated organizations has shown that when one aspect of a company's operations becomes imperiled, the entire organization may be negatively impacted.

Although a significant number of comments favored excluding debt of certain subsidiaries from a parent company's HLT designation if appropriate protective covenants are maintained between the parent and subsidiary, the agencies found significant problems related to the use and review of protective covenants. Protective covenants cited as examples include restrictions on the movement of assets between parent and subsidiary companies, limitations on the payment of dividends to a parent company, restrictions on inter-company debt, and so forth. Each protective covenant, however, is unique, thus requiring a very difficult and time consuming review and evaluation process to determine its strength. Also, protective covenants may not work as specified when a company is in financial difficulty or enters bankruptcy proceedings. Experience has shown that technical separation of companies through the use of loan covenants has not always been effective in protecting a company against liabilities emanating from its parent, subsidiary, or affiliate, especially in bankruptcy situations where the separation between parent and subsidiary can and has been breached.

Given a desire to adhere closely to GAAP whenever possible, the influence that parent companies can exert over

so-called "stand alone" subsidiaries when financial needs arise, and the difficulties involved in evaluating and enforcing protective covenants, the agencies have determined not to exclude certain subsidiaries of HLT parent companies from the HLT designation.

### Definition and Guidance Regarding Highly-Leveraged Transactions ("HLT's"), As Revised

#### Summary of Definition

A bank or bank holding company is considered to be involved in a highly-leveraged transaction when credit is extended to or investment is made in a business where the financing transaction involves the buyout, acquisition, or recapitalization of an existing business and one of the following criteria is met:

- (a) The transaction results in a liabilities-to-assets leverage ratio higher than 75 percent; or
- (b) The transaction at least doubles the subject company's liabilities and results in a liabilities-to-assets leverage ratio higher than 50 percent; or
- (c) The transaction is designated an HLT by a syndication agent or a federal bank regulator.

#### Additional Guidance on the Definition of HLTs

A highly-leveraged transaction is a type of financing which involves the restructuring of an ongoing business concern financed primarily with debt. The purpose of an individual credit is most important when initially determining HLT status. Once an individual credit is designated as an HLT, all currently outstanding and future obligations of the same borrower are also included in HLT totals. This includes working capital loans and other ordinary credits, until such time as the borrower is delisted.

The regulatory purpose of the HLT definition is to provide a consistent means of aggregating and monitoring this type of financing transaction. It must be pointed out that the HLT designation does not imply a supervisory criticism of a credit. Before any HLT or any other credit is criticized, an examiner should review a whole range of factors on a credit-by-credit basis. These factors include cash flow, general ability to pay interest and principal on outstanding debt, economic conditions and trends, the borrower's future prospects, the quality and continuity of the borrower's management, and the lender's collateral position. Participation of banking organizations in highly-leveraged

transactions is not considered inappropriate so long as it is conducted in a sound and prudent manner, including the maintenance of adequate capital and loan loss reserves to support the risks associated with these transactions.

Borrowers having questions regarding the HLT definition should first refer these questions to their bankers. Bankers should then refer questions they cannot answer to the bank's primary federal regulator.

#### *Purpose Test*

To become eligible for designation as an HLT, a financing transaction must involve the buyout, acquisition, or recapitalization of an existing business, domestic or foreign. This definition encompasses traditional leveraged buyouts, management buyouts, corporate mergers and acquisitions, and significant stock buybacks. Leveraged Employee Stock Option Plans (ESOPs) are also included when used to acquire or recapitalize an existing business.

For purposes of satisfying the HLT purpose test, a leveraged recapitalization involves a replacement of equity with debt on a company's balance sheet by means of a stock repurchase or dividend payout. Refinancing existing debt in a company is not deemed to be a leveraged recapitalization.

#### *Exclusions from the HLT Definition*

**Single Asset or Lease:** This purpose test excludes the acquisition or recapitalization of a single asset or lease (e.g., a large commercial building or an aircraft); or a shell company formed to hold a single asset or lease, from the HLT definition. Although such an acquisition may be highly leveraged, the asset or lease, in and of itself, is not considered an ongoing business concern and, therefore, is not intended to be included in the HLT category. However, the acquisition or recapitalization of a leasing corporation which invests in fleets of equipment for leasing, or a building company which invests in real estate projects would satisfy the HLT purpose test.

**Threshold Test:** Loans and exposures to any obligor in which the total financing package, including all obligations held by all participants, does not exceed \$20 million, at the time of origination, may be excluded from HLT designation. Nonetheless, there may be some banking organizations that in the aggregate have significant exposure to transactions below the threshold level. It is expected that those organizations would continue to monitor closely these

transactions as part of their aggregate HLT exposures.

**Historical Cutoff Date:** An HLT transaction not included in the Shared National Credit Program, that meets or exceeds the \$20 million test, may be excluded from HLT designation if it originated prior to January 1, 1987, the original terms and conditions of the credit are materially unchanged, the credit has not been criticized by examiners, and the financial condition of the debtor has not deteriorated.

**Debtor-in-Possession Financings:** Court-approved debtor-in-possession (or trustee-in-possession) financing for a business concern in Chapter 11 reorganization proceedings will generally be exempt from HLT designation. All pre-petition debt of an HLT borrower and any post-reorganization debt (after a company emerges from Chapter 11 bankruptcy) will continue to be included in HLT exposure until delisting occurs.

**Loans Fully Collateralized With Cash or Cash Equivalents:** All loans (credit facilities) that are fully-collateralized with cash or cash equivalents are excluded from HLT reporting by banking organizations. Cash collateral consists of a deposit in the financial institution advancing the loan proceeds, segregated and under the control of the financial institution, and unequivocally pledged to secure the loan. Cash equivalents are deemed to include U.S. Government and certain other readily-marketable securities qualifying for a zero risk-weight under risk-based capital standards. Cash equivalents must be held in custody by and unequivocally pledged to the lending financial institution.

#### *Leverage Tests*

In addition to the purpose test, one of the following criteria must be met for the transaction to be considered an HLT:

(1) The transaction at least doubles the subject company's liabilities and results in a total liabilities to total assets (leverage) ratio higher than 50 percent.

**Note:** The purpose of this leverage test is to capture transactions in which a company must suddenly deal with a substantially higher debt burden. The greatest risk in a credit exposure is not necessarily the absolute level of debt but may be the impact on a company of significant new debt. A key HLT success factor is ability to handle a sudden, large increase in debt.

The "doubling of liabilities" is intended to capture those transactions where new debt is used to facilitate the buyout, acquisition, or recapitalization of a business. If the sum of the acquiring and acquired companies' liabilities would double as a result of the new debt

taken on to effect the combination of the companies, then the transaction is considered an HLT, and all exposure to the company is designated an HLT. It is not intended to cover a doubling resulting from the simple addition of the existing liabilities of the two companies.

Any refinanced portion of old debt in a transaction should continue to be treated as old debt for purposes of applying this leverage test. Further, if there was no debt in either company prior to the transaction, then any new debt will result in a "doubling of liabilities."

In an acquisition involving one or more operating divisions of a company (as opposed to stand-alone subsidiaries), existing liabilities of the seller associated with specific operating assets being transferred in the transaction may be allocated to the resulting company for purposes of applying the "doubling of liabilities" test. The burden of proof is on the resulting company and its financial institution(s) to substantiate that the allocation of the seller's liabilities to the resulting company is appropriate.

When calculating a company's leverage for the purpose of this test, captive finance company subsidiaries and subsidiary depository institutions should be excluded from the consolidated organization.

(2) The transaction results in a total liabilities to total assets (leverage) ratio higher than 75 percent.

**Note:** When a company's leverage ratio exceeds 75 percent, the determination of whether exposure to the company is designated an HLT further depends on the composition of the company's total liabilities after the transaction. If a significant portion of the liabilities (generally 25 percent or more of total liabilities) derives from buyouts, acquisitions, or recapitalizations, either past or present, then all exposure to the company is designated an HLT. If, after the transaction, debt related to buyouts, acquisitions, or recapitalizations, either past or present, represents less than 25 percent of total liabilities, then the exposure to the company need not be designated an HLT.

Again, when calculating a company's leverage for the purpose of this test, captive finance company subsidiaries and subsidiary depository institutions should be excluded from the consolidated organization.

(3) The transaction is designated an HLT by a syndication agent.

In specific cases, the bank supervisory agencies may also designate a transaction as an HLT even if it does not meet the conditions outlined above. (It is anticipated that this would be done infrequently and only in material cases).

*Definition of the Leverage Ratio*

The leverage ratio is total liabilities divided by total assets as reflected in financial statements prepared in accordance with generally accepted accounting principles (GAAP). Total assets of the resulting enterprise include intangible assets (such as goodwill). Total liabilities include all forms of debt (including any new debt taken on to facilitate the transaction) and claims, including all subordinated debt and non-perpetual preferred stock. Perpetual preferred stock is generally considered equity for purposes of calculating HLT leverage. However, exceptions could be made on a case-by-case basis if the stock has characteristics more akin to debt than equity.

Off-balance sheet exposure, including claims related to foreign exchange contracts, interest rate swaps, and other risk protection or cash management products may normally be excluded from HLT exposure as long as their credit equivalent exposure is small relative to other types of obligations. (It is expected, however, that internal management information and control systems be in place to capture these exposures.)

If a parent company uses "double leverage" (that is, takes on debt and downstreams it as equity to a subsidiary) to assist a subsidiary in an HLT purpose-related transaction, then the debt at the parent company will be considered HLT purpose-related debt when calculating leverage for the company on a consolidated basis.

In an acquisition involving a pure assumption of debt with no new debt issued, the transaction is not designated an HLT unless the resulting company's aggregate outstanding HLT purpose-related debt (from all previous transactions) is significant (generally 25 percent or more of total liabilities) and the 75 percent leverage test is satisfied.

*Consolidation of HLT Exposure*

All credit extended to, or investments made in an HLT should be aggregated with any ordinary business loans to, or investments in, the same obligor.

If a company satisfies the HLT purpose and leverage tests on a consolidated basis, then a loan to any part of the organization is deemed to be an HLT. On the other hand, if only a subsidiary of a company satisfies the HLT tests, then the subsidiary could "stand alone" as an HLT; however, if the subsidiary's debt level is significant enough to cause the consolidated organization to meet HLT leverage criteria, then all debt of the entire organization is designated HLT.

*Guarantees of Payment*

If a parent company supplies an irrevocable, unconditional guarantee of payment on behalf of its subsidiary and the leverage of the consolidated organization does not meet HLT leverage criteria, then the subsidiary will generally not be designated an HLT. On the other hand, if the subsidiary's leverage is significant enough to cause the consolidated organization to meet HLT leverage criteria, then all debt of the entire organization is accorded HLT status.

(Note: Third-party guarantees and guarantees by related subsidiaries of a company have no effect on the HLT designation. While these types of guarantees offer credit enhancement benefits which will be taken into consideration during the review of individual credits by examiners, they generally lack the stronger bonds of support inherent in the relationship between a parent and its subsidiary.)

When a foreign parent company provides the equivalent of an irrevocable and unconditional guarantee of payment on behalf of a subsidiary, the subsidiary's debt will normally not be designated as HLT debt as long as the consolidated organization does not meet HLT leverage criteria and the following two conditions are met:

(1) Written opinions from legal counsel in the country of origin and the United States are provided which state that the equivalent of a written guarantee of debt repayment exists which is irrevocable and unconditional; and

(2) The credit files in the U.S. banking organizations lending to the subsidiary contain consolidated financial statements for the foreign parent stated in U.S. dollars under U.S. accounting rules.

*Agent and Lead Bank Responsibility*

To ensure consistent application of the definition, the agent or lead bank is responsible for determining whether or not a transaction qualifies as an HLT. The agent or lead bank is charged with the timely notification to participants regarding the status of the transaction and of any change in that status, i.e. designation as an HLT or delisting as an HLT.

The responsibility of the agent or lead bank to determine HLT status does not preclude a participant bank from designating a transaction as an HLT or relieve a participant from performing its own credit analysis. Examiners will review transactions for compliance with the HLT definition in the context of the Shared National Credit Program and

during regular on-site examinations.

*Delisting Criteria*

HLT exposure of a given borrower may be removed from HLT status upon satisfying one of the following criteria:

(a) Credits of a company emerging from protection under Chapter 11 of the U.S. Bankruptcy Code at the consummation of a court-approved plan of reorganization will be immediately delisted from HLT status, if the company's leverage ratio is less than 75 percent at the time of reorganization.

(b) A borrower's credits that were designated as HLTs under the "doubling of liabilities to greater than 50 percent" leverage test or that have reduced leverage to less than 75 percent will be considered eligible for delisting if the company has performed well for one year (since its last buyout, acquisition, or leveraged recapitalization involving financing) and demonstrates an ability to continue satisfactorily servicing debt. To verify adequate performance and validate the appropriateness of financial projections of a company, the lender should conduct a thorough review of the obligor to include, at a minimum, overall management performance against the business plan, cash flow coverages, operating margins, industry risk, and status of asset sales, if applicable.

(c) Credits of a company whose leverage continues to exceed the 75 percent leverage test will be considered eligible for delisting by banking organizations on a case-by-case basis, if the company demonstrates superior cash flow coverage, relative to the company's industry or peer group, and the company has adequately serviced debt for a reasonable period of time since its last buyout, acquisition, or leveraged recapitalization involving financing. To verify strong performance, the lender should conduct a thorough review of the obligor to include, at a minimum, the quality and strength of cash flow coverages, operating margins, reduction in leverage, appropriateness of the company's financial projections, overall management performance against the business plan, industry risk, and status of asset sales, if applicable. Credits delisted in this manner will subsequently be reviewed, and potentially subject to relisting, by examiners during the normal course of an examination.

(d) Credits of a company whose leverage continues to exceed the 75 percent leverage test will be considered eligible for delisting if the company has performed adequately for at least three years since its last buyout, acquisition,

or leveraged recapitalization involving financing; and the company has a positive net worth. To verify adequate performance and validate the appropriateness of financial projections of a company, the lender should conduct a thorough review of the obligor to include, at a minimum, overall management performance against the business plan, cash flow coverages, operating margins, industry risk, and status of asset sales, if applicable.

It is expected that banks will maintain records of delisted exposures and reasons for delisting. After delisting, any significant changes in the obligor's financial condition should cause the exposure to be reviewed for relisting. Record pertaining to delisting and relisting of HLTs will be reviewed by examiners in the context of the Shared National Credit Program and/or regular on-site examinations.

Dated: February 6, 1992.

**Robert L. Clarke,**

*Comptroller of the Currency.*

**Hoyle L. Robinson,**

*Executive Secretary of the Federal Deposit Insurance Corporation.*

**William W. Wiles,**

*Secretary of the Board of Governors of the Federal Reserve System.*

[FR Doc. 92-3185 Filed 2-10-92; 8:45 aml

BILLING CODES: 4810-33-M, 6714-01-M, 6210-01-M