# Lead Left Interview – Kathryn Dick (Part 2)

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**This week we continue our conversation with Kathryn Dick, Managing Director, Promontory Financial Group. Kathy advises clients on regulatory issues, risk management, and capital market activities. Prior to Promontory, Kathy had a 26-year tenure at the Office of the Controller of the Currency.** ***Second of two parts – View part one***

***The Lead Left: There's concern among bank that Leveraged Lending Guidelines shouldn't be one-size-fits all.***

**Kathryn Dick:** These are, after all, "guidelines," But banks need to understand that the bar is set higher after the crisis. The banking agencies are comfortable with loans set within the boundaries of the guidance. Outside of those, you'll have to defend your decision. And while it's clear that some industries can withstand higher leverage, banks need to be able to show the loan is still a pass credit and be prepared for examiner scrutiny. In my opinion, it could take as long as five years for consistency to be established.

***TLL: Now you're advising banks in your role at Promontory, what are you telling them?***

**KD:** It takes examiners time to get comfortable with banks' risk management programs. They understand that banks have to grow, but by their nature examiners are skeptical. Structured credits have many features and it is difficult to know just how much an originating bank can move the levers and still have a "pass" credit. This is subject to examiner interpretation, and I expect that sometime in the future, there will be more comfort with structures that are tough to get through now. Examiners focus on policy exceptions. They can't look at every loan so if the risk appetite is set up correctly, with fewer exceptions there should be fewer problems. The responsibility for ensuring that the risk appetite is consistent with examiner expectations is on management and boards, so they understand the consequences.

***TLL: What have you found clients are most worried about?***

**KD:** Many firms have not enhanced their controls sufficiently to oversee leveraged and asset based loans. These loans are considered specialized credits and examiner expectations for controls are higher here than for a traditional commercial loan. Institutions continue to show up as not meeting examiner expectations, and in some cases, "Matters Requiring Attention" (MRAs) have been outstanding for four or five years. They need to be fixed.

***TLL: Why the delay?***

**KD:** Part of it is a lack of understanding exactly what is and what is not a "pass" credit, and part is not wanting to spend the money to build the kind of infrastructure and systems it takes to fix the problems. Firms willing to invest will have a real opportunity. Examiners will chase out those not willing to do so. There are great opportunities for those who make the commitment up front.

***TLL: And if there's a shakeout?***

**KD:** I believe the regulators are comfortable with fewer leveraged lending players.

***TLL: What about the shadow banks? Do regulators understand the consequences of pushing "risky loans" outside of where they can be monitored?***

**KD:** In previous cycles, examiners worried about the hedge funds. The OCC built up relationships with private equity and hedge funds to avoid problems like LTCM by better understanding what kind of leverage was rising outside of the regulated institutions. Then the crisis came and it turned out *not* to be the hedge funds and PE. Treasury created the Financial Stability Oversight Council, a by-product of Dodd-Frank, to improve coordination among agencies. Congress elected not to create one regulatory agency responsible for oversight of the whole system. We needed transparency; multiple regulators can make this more challenging.

***TLL: What are the risks if leveraged loans are held outside the banking system?***

**KD:** Well, it negates the capability banks have to moderate the peaks and valleys of business cycles and work with troubled borrowers when times are tough. Banks, after all, are maturity transformation vehicles. They convert short-term deposits to long-term credit. In the banking system regulators can oversee the evaluation of borrowers and banks and mute the economic impact of recessions.

***TLL: What's the biggest challenge for regulators?***

**KD:** To strike the right balance between safety and soundness expectations and growth. It's important to identify where risk capital can be safely deployed to spur economic growth or, we risk having a weak and isolated banking system. It will be difficult to attract the right employees and investors.

***TLL: Kathy, what was your biggest surprise last year?***

**KD:** Probably that we haven't seen more messaging from policy makers globally acknowledging the growing shadow banking risk. I think there should be more discussion.

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