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Client Alert

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Federal Reserve Releases Updated, Detailed Terms of Main Street Lending Program

On April 30, 2020, the Federal Reserve announced certain updates to its Main Street Lending Program which the Federal Reserve initially unveiled on April 9, 2020. Since the initial announcement of the Main Street Lending Program, the Federal Reserve has received over 2,200 comment letters providing input from individuals, non-profits, and businesses. The April 30 updates are reflected in revised term sheets for each of the three distinct facilities comprising the Main Street Lending Program and an FAQ that provides more detail on the operation of the Main Street Lending Program. The FAQ, which contains certain information not described in this summary, can be found here.

The Main Street Lending Program is referred to under Title IV of the Coronavirus Aid, Relief, and Economic Security Act (**CARES Act**) and is designed to provide support to small and medium-sized businesses that were in a sound financial position prior to the COVID-19 pandemic. The Main Street Lending Program will provide this support through the Federal Reserve's purchase of up to $600 billion in participations in loans to "Eligible Borrowers" from "Eligible Lenders."

The Main Street Lending Program consists of three distinct facilities authorized under Section 13(3) of the Federal Reserve Act:

- the Main Street New Loan Facility (the **New Facility**);
- the Main Street Priority Loan Facility (the **Priority Facility**); and
- the Main Street Expanded Loan Facility (the **Expanded Facility**).

The New Facility, Priority Facility and the Expanded Facility are collectively referred to as the **Main Street Facilities**.

The New Facility and the Priority Facility seek to facilitate the availability of new loans to Eligible Borrowers with the Priority Facility providing larger maximum loan sizes than the New Facility along with different repayment terms. The Expanded Facility seeks to facilitate increases to Eligible Borrowers' existing credit facilities through the addition of upsized tranches to such existing facilities.

The Main Street Facilities are separate and distinct from the Paycheck Protection Program established under the CARES Act (PPP). As outlined below, the Main Street Facilities require a different mix of restrictions and conditions than PPP loans and no portion of Eligible Loans, or in the case of the Expanded Facility, the upsized tranche of an Eligible Loan, originated pursuant to the Main Street Facilities may be forgiven. As further outlined below, the determination of Eligible Businesses for the Main Street Facilities is subject to the affiliation rules used by the SBA. Unlike in the PPP, Eligible Businesses are not obligated to certify regarding the necessity of the loan to support ongoing operations due to current economic uncertainty.

The Main Street Facilities will be structured as a commitment to lend by the Federal Reserve Bank of Boston on a recourse basis to a single common special purpose investment vehicle (the **SPV**) that will purchase on or before September 30, 2020, par value, a 95% participation in Eligible Loans or the upsized tranche of an Eligible Loan, as applicable, made under the New and Expanded Facility and an 85% participation in Eligible Loans made under the Priority Facility.

General Eligibility for the Main Street Facilities

To be considered an **Eligible Borrower** for purposes of the Main Street Facilities, businesses must satisfy each of the following criteria:

(a) have been established prior to March 13, 2020;

(b) not be an "Ineligible Business"[1];

(c) either employ less than 15,000 employees *or* have 2019 annual revenues of less than $5 billion (note that each of these limits require the business to aggregate its total number of employees or revenues with its affiliates[2]);

(d) be created or organized in the United States or under the laws of the United States with significant operations in the United States (in the case of a joint venture, with no more than 49% participation by foreign business entities);

(e) have a majority of its employees based in the United States[3];

(f) if the business had an outstanding loan with the Eligible Lender as of December 31, 2019, (which in the case of the Expanded Facility shall be the Eligible Loan with respect to which the upsized tranche is being provided), such loan must have had an internal risk rating (based on the Eligible Lender's risk rating system) that was equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system as of December 31, 2019; and

(g) have not received specific support pursuant to Title IV of the CARES Act.

Eligible Borrowers may only participate in one of the Main Street Facilities. The Main Street Facilities will be available to businesses that have participated (or that have affiliates that have participated) in the PPP but businesses may not participate in the Main Street Facilities if they have participated in the Federal Reserve's Primary Market Corporate Credit Facility (purchases of bonds from and loans to large, investment grade eligible businesses).

[1] "Ineligible Businesses" for purposes of the Main Street Facilities, are those businesses listed in 13 CFR 120.110(b) – (j) and (m) – (s), as modified by regulations implementing the PPP. The term sheets for the Main Street Facilities state that these restrictions may be modified at the discretion of the Federal Reserve. Businesses should review these restrictions to confirm eligibility.

[2] Note that the SBA affiliation rules (based on 13 CFR 121.301(f)) applicable to participants in the PPP will be applied for purposes of "affiliates" in this test. Pages 10 and 11 of the Main Street Lending Program FAQ released by the Federal Reserve contain further information on calculation of employee size and revenues. The revenue limits must be based on (i) the business's (and its affiliates') annual revenue per its 2019 GAAP-compliant, audited financial statements, or (ii) the business's (and its affiliates') annual receipts for its fiscal year 2019, as reported to the IRS. If 2019 audited financial statements or annual receipts of the business for fiscal year 2019 are not available, the business should use its most recent audited financial statements or annual receipts.

[3] Note, the Main Street Lending Program FAQ is not express as to whether employees of "affiliates" (as determined pursuant to the SBA affiliation rules contained in 13 CFR 121.301(f)) of the Eligible Business should be included for purposes of making this determination.

Eligible Lenders under the Main Street Facilities are US federally insured depository institutions (including a bank, savings association, or credit union), US bank holding companies, US branches or agencies of foreign banks, US savings and loan holding companies, US intermediate holding companies of foreign banking organizations, or any US subsidiary of any of the foregoing.

For purposes of the Expanded Facility, the Eligible Lender must be one of the lenders that holds an interest in the underlying Eligible Loan at the date of upsizing.

Economic Terms of all Eligible Loans

Eligible Loans under the New Facility and the Priority Facility and the upsized tranche of the Eligible Loan under the Expanded Facility must contain the following features (the **General Economic Features**):

(a) four-year maturity;

(b) deferral of principal and interest payments for one year from origination (interest will be capitalized);

(c) adjustable interest rate of LIBOR (1 or 3 months) plus 300 basis points; and

(d) prepayment without penalty.

Eligible Loans may be secured or unsecured term loans or, in the case of the Expanded Facility, revolving credit facilities pursuant to which a term loan upsized tranche is made reflecting the features identified above. Section 4003(d)(3) of the CARES Act expressly provides that the principal amount of Eligible Loans under the New Facility and the Priority Facility and the upsized tranche of the Eligible Loan under the Expanded Facility may not be reduced through loan forgiveness.

The Eligible Lender must retain its 5% (or 15% in the case of the Priority Facility) portion of the Eligible Loan (or, in the case of the Expanded Facility, the upsized tranche of the Eligible Loan) until the Eligible Loan or the upsized tranche of the Eligible Loan, as applicable, matures or the SPV sells all of its 95% (or 85% in the case of the Priority Facility) participation, whichever comes first. In the case of the Expanded Facility, the Eligible Lender must also retain its interest in the underlying Eligible Loan until the underlying Eligible Loan matures, the upsized tranche of the Eligible Loan matures, or the SPV sells all of its 95% participation in the upsized tranche of the Eligible Loan, whichever comes first. The SPV and the Eligible Lender will share risk in the Eligible Loan or the upsized tranche of the Eligible Loan in the case of the Expanded Loan Facility on a *pari passu* basis.

Economic Terms Specific to the New Facility

In addition to the General Economic Features, Eligible Loans under the New Facility must contain the following features:

(a) principal amortization over the life of the Eligible Loan of 1/3 of the principal of the Eligible Loan at the end of the second year, 1/3 of the principal of the Eligible Loan at the end of the third year, and 1/3 of the principal of the Eligible Loan at maturity at the end of the fourth year (for purposes of this calculation, principal includes capitalized interest);

(b) minimum loan size of $500,000;

(c) maximum loan size that is the lesser of (i) $25 million or (ii) an amount that, when added to the Eligible Borrower's existing outstanding and undrawn available debt[4] (as of the date of the loan application), does not exceed four times the Eligible Borrower's adjusted 2019 EBITDA[5];

(d) the Eligible Loan made under the New Facility cannot be, at the time of origination or at any time during the term of the Eligible Loan, contractually subordinated in terms of priority to any of the Eligible Borrower's other loans or debt instruments;

(e) Eligible Lenders must pay a transaction fee of 100 basis points of the principal amount of the Eligible Loan at the time of origination to the SPV and may pass this fee through to the Eligible Borrower; and

(f) Eligible Lenders, at their discretion, may also charge an origination fee of up to 100 basis points of the principal amount of the Eligible Loan at the time of origination to the Eligible Borrower.

Economic Terms Specific to the Priority Facility

In addition to the General Economic Features, Eligible Loans under the Priority Facility must contain the following features:

(a) principal amortization over the life of the Eligible Loan of 15% of the principal of the Eligible Loan at the end of the second year, 15% of the principal of the Eligible Loan at the end of the third year, and a balloon payment of 70% of the principal of the Eligible Loan at maturity at the end of the fourth year (for purposes of this calculation, principal includes capitalized interest);

(b) minimum loan size of $500,000;

(c) maximum loan size that is the lesser of (i) $25 million or (ii) an amount that, when added to the Eligible Borrower's existing outstanding and undrawn available debt (as of the date of the loan application), does not exceed six times the Eligible Borrower's adjusted 2019 EBITDA[6];

(d) at the time of origination and at all times the Eligible Loan is outstanding, the Eligible Loan is senior to or *pari passu* with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt (see note below regarding refinancing of existing debt held by lenders other than the Eligible Lender);

(e) Eligible Lenders must pay a transaction fee of 100 basis points of the principal amount of the Eligible Loan at the time of origination to the SPV and may pass this fee through to the Eligible Borrower; and

[4] As used in each of the term sheets, "existing and undrawn available debt" includes all amounts borrowed under any loan facility, including unsecured or secured loans from any bank, non-bank financial institution or private lender, as well as any publicly issued bonds or private placement facilities. It also includes all unused commitments under any loan facility, excluding (i) any undrawn commitment that serves as a backup line for commercial paper issuance, (ii) any undrawn commitment that is used to finance receivables (including seasonal financing of inventory), (iii) any undrawn commitment that cannot be drawn without additional collateral, or (iv) any undrawn commitment that is no longer available due to a change in circumstances.

[5] Note that the term sheets allow for the use of "adjusted" EBITDA, which is commonly used by borrowers for reporting under existing facilities. "Adjusted" EBITDA for purposes of the New Facility and the Priority Facility must be a methodology previously used by the Eligible Lender for determining EBITDA when extending credit to the Eligible Borrower or to similarly situated borrowers on or before April 24, 2020.

[6] See Footnote 5 above regarding calculation of "adjusted" EBITDA.

(f) Eligible Lenders, at their discretion, may also charge an origination fee of up to 100 basis points of the principal amount of the Eligible Loan at the time of origination to the Eligible Borrower.

In addition to these requirements, the Federal Reserve notes that Eligible Borrowers under the Priority Facility may, at the time of origination of the Eligible Loan, refinance existing debt that is owed to a lender other than the Eligible Lender.

Economic Terms Specific to the Expanded Facility

In addition to the General Economic Features, upsized tranches of Eligible Loans under the Expanded Facility must contain the following features:

(a) the Eligible Loan that is being upsized must be a secured or unsecured term loan or revolving credit facility made by an Eligible Lender(s) to an Eligible Borrower that was originated on or before April 24, 2020, provided that the upsized tranche of the loan is a term loan;

(b) the Eligible Loan that is being upsized must have a remaining maturity of at least 18 months (taking into account any adjustments made to the maturity of the loan after April 24, 2020, including adjustments made at the time of upsizing);

(c) principal amortization of 15% of the principal of the upsized tranche at the end of the second year, 15% of the principal of the upsized tranche at the end of the third year, and a balloon payment of 70% of the principal of the upsized tranche at maturity at the end of the fourth year (for purposes of this calculation, principal includes capitalized interest);

(d) minimum loan size of the upsized tranche of $10 million;

(e) maximum size of the upsized tranche that is the lesser of (i) $200 million, (ii) 35% of the Eligible Borrower's existing outstanding and undrawn available debt that is *pari passu* in priority with the upsized tranche of the Eligible Loan and equivalent in secured status (i.e., secured or unsecured), or (iii) an amount that, when added to the Eligible Borrower's existing outstanding and undrawn available debt (as of the date of the loan application), does not exceed six times the Eligible Borrower's adjusted 2019 EBITDA[7];

(f) at the time of upsizing and at all times the upsized tranche is outstanding, the upsized tranche must be senior to or *pari passu* with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt;

(g) Eligible Lenders must pay a transaction fee of 75 basis points of the amount of the upsized tranche to the SPV and may pass this fee on to the Eligible Borrower;

(h) Eligible Lenders may also charge an origination fee equal to 75 basis points of the amount of the upsized tranche to the Eligible Borrower at the discretion of the Eligible Lender; and

(i) Any collateral securing the Eligible Loan (at the time of upsizing or any subsequent date) must secure the upsized tranche on a pro rata basis.

[7] "Adjusted" EBITDA for purposes of the Expanded Facility must be determined using the methodology previously used by the Eligible Lender for determining EBITDA when originating or amending the Eligible Loan.

Restrictions and Conditions

Each of the Main Street Facilities requires Eligible Borrowers and Eligible Lenders to make certain commitments and to agree to specific restrictions as a condition to originating or receiving loans, as applicable, under the Main Street Facilities as set forth below:

(a) each of the Eligible Borrower and the Eligible Lender must commit to refrain from repaying, or demanding repayment by the Eligible Borrower of, as applicable, the principal balance of, or paying, or demanding payment by the Eligible Borrower of, as applicable, any interest on, any debt until the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) is repaid in full, unless the debt or interest payment is mandatory and due[8];

(b) each of the Eligible Borrower and Eligible Lender must commit that it will not seek to cancel or reduce any of the committed lines of credit the Eligible Borrower has with the Eligible Lender, and the Eligible Borrower must include its committed lines of credit with any other lender in this commitment[9];

(c) for Eligible Loans made under the New Facility and the Priority Facility, the Eligible Lender must certify that the methodology used in calculating the Eligible Borrower's adjusted 2019 EBITDA for the maximum Eligible Loan size is the methodology it has previously used for adjusting EBITDA when extending credit to the Eligible Borrower or similarly situated borrowers on or before April 24, 2020, and in the case of loans made under the Expanded Facility, the Eligible Lender must certify that the methodology used in calculating the Eligible Borrower's adjusted 2019 EBITDA for the maximum upsized tranche is the same methodology it previously used for adjusting EBITDA when originating or amending the Eligible Loan (which is being upsized) on or prior to April 24, 2020;

(d) the Eligible Borrower must certify that it has a reasonable basis to believe that, as of the date of the origination of the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility), and after giving effect to such Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility), it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period;

(e) the Eligible Borrower must commit to a prohibition on stock buybacks (of equity securities listed on a national securities exchange of the Eligible Borrower or any parent company of the Eligible Borrower), unless prior contractual obligations exist as of March 27, 2020, until one year after the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) has been paid in full[10];

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[8] This does not prohibit the Eligible Borrower from (i) repaying a line of credit (including credit cards) in accordance with the Eligible Borrower's normal course of business usage for such line of credit, (ii) taking on and paying additional debt obligations required in the normal course of business and on standard terms, including inventory and equipment financing, provided that such debt is secured by newly acquired property (e.g., inventory and equipment) and apart from such security, is of equal or lower priority than the Eligible Loan, or (iii) refinancing maturing debt.

[9] This does not prohibit an Eligible Borrower from (i) reducing or terminating uncommitted lines of credit, (ii) allowing the expiration of existing lines of credit in accordance with their terms, or (iii) reducing availability under existing lines of credit in accordance with their terms due to changes in borrowing bases or reserves in asset-based or similar structures.

[10] The CARES Act is not clear as to whether this prohibition in the case of a parent company applies just to purchases by the Eligible Borrower or also to purchases by the parent company itself. For industry-specific Title IV CARES Act relief, the parent company is expressly restricted, but not in the section of Title IV applicable to the Main Street Facilities.

(f) the Eligible Borrower must commit to a complete restriction on dividend payments or capital distributions in respect of common stock of the Eligible Borrower until one year after the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) has been paid in full; provided, however, that this restriction will not apply to S corporations or other tax pass-through entities that are Eligible Borrowers to the extent dividends or distributions are reasonably required to cover their owners' tax obligations in respect of the Eligible Borrower's earnings;

(g) the Eligible Borrower must commit that it will comply with the employee compensation limits set forth in Section 4004 of the CARES Act (discussed below); and

(h) the Eligible Borrower and the Eligible Lender must each certify that it is eligible to participate in the applicable Main Street Facility in light of the conflicts of interest prohibition in Section 4019(b) of the CARES Act (discussed below).

Borrowers will need to carefully review existing debt agreements to determine the need for any amendments to, among other things, permit incurrence of new or upsized loans and accommodate required repayment restrictions upon outstanding loans prior to the repayment in full of any Eligible Loans (or upsized tranche thereof with respect to the Expanded Facility).

Eligible Lenders are expected to collect the required certifications and covenants from each Eligible Borrower at the time of making or upsizing the Eligible Loan and may rely on an Eligible Borrower's certifications and covenants as well as any subsequent self-reporting by the Eligible Borrower.

Employee Retention

The term sheets for the Main Street Facilities state that all Eligible Borrowers "should" make commercially reasonable efforts to maintain their payroll and retain employees during the time the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) is outstanding. The Federal Reserve FAQ clarifies that Eligible Borrowers should undertake good-faith efforts to maintain payroll and retain employees, in light of their capacities, the economic environment, the Eligible Borrower's available resources, and the Eligible Borrower's need for labor. Businesses that have already laid-off or furloughed workers as a result of the COVID-19 pandemic are eligible to borrow under the Main Street Lending Program.

Restrictions on Employee Compensation

Section 4003(c)(3)(A)(III) of the CARES Act provides that all Federal Reserve Programs providing direct loans and receiving Department of Treasury support under Section 4003(b)(4) of the CARES Act, including the Main Street Facilities, require restrictions on employee compensation for borrowers. These restrictions last for the term of any Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) plus one year and are as follows:

(a) no officer or employee whose total compensation was greater than $425,000 in 2019 can receive pay increases or be offered severance or other benefits that exceed more than two times their maximum compensation received in 2019; and

(b) no officer or employee whose total compensation was greater than $3,000,000 in 2019 can receive compensation in excess of (i) $3,000,000, plus (ii) 50% of the amount by which such person's 2019 compensation exceeded $3,000,000.

“Total compensation” includes salary, bonuses, awards of stock, and other financial benefits provided by an Eligible Borrower to an officer or employee. The CARES Act does not specify when or how “awards of stock” are to be valued for purposes of determining total compensation.

Conflicts of Interest

Eligible Borrowers under the Main Street Facilities will have to certify that they are eligible to receive an Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) in light of the conflicts of interest prohibition set forth in Section 4019(b) of the CARES Act. That section provides that no “covered entity” is eligible to participate in programs established pursuant to Section 4003 of the CARES Act. A “covered entity” is an entity in which a “covered individual” holds a 20% or greater equity interest. A “covered individual” is defined as the president, the vice president, the head of a cabinet department, or a member of Congress along with any of these individuals’ spouses, children, or sons-in-law or daughters-in-law. “Equity interest” is defined broadly to mean (a) a share or stock interest, (b) capital or profits interest in a limited liability company or partnership, or (c) a warrant or right (other than a right to convert) to either of the interests in (a) or (b).

Interaction with CARES Act

The combined size of the Main Street Facilities will be up to $600 billion including a $75 billion equity investment in the SPV by the Department of Treasury using funds appropriated under Title IV of the CARES Act. Section 4003(c)(3)(D)(ii) of the CARES Act expressly provides that the restrictions under Section 4003(c)(3)(D)(i) of the CARES Act required for the mid-size business loan facilities that the Department of Treasury is mandated with implementing under Title IV of the CARES Act are not required to apply to the Main Street Facilities.

Public Disclosure

The Federal Reserve will publicly disclose information regarding the Main Street Facilities including the names of lenders, borrowers, amounts borrowed, interest rates charged and overall costs, revenues, and fees related to the Main Street Lending Program. Eligible Borrowers should expect that their participation in the Main Street Lending Program will become public knowledge and that the high-level terms (e.g., interest rates and amount borrowed) related to their Eligible Loan will also be publicly disclosed.

Next Steps

As of publication, the date that the Main Street Facility would be available to Eligible Borrowers has not been announced. Potential borrowers should contact their existing lenders and bankers regarding the availability of the Main Street Facilities as well as to understand the underwriting requirements that will be applied by their lenders.

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