Client Alert

April 2020

Federal Reserve Releases High-Level Terms of Main Street Lending Program

On April 9, 2020, the Federal Reserve announced actions providing up to $2.3 trillion in loans to support the US economy. These actions included the creation of two facilities that comprise the Main Street Lending Program referred to under Title IV of the Coronavirus Aid, Relief, and Economic Security Act (**CARES Act**). The purpose of the Main Street Lending Program is to facilitate lending to small and medium-sized businesses through the Federal Reserve's purchase of up to $600 billion in loans to "Eligible Borrowers" from "Eligible Lenders."

The Main Street Lending Program consists of two facilities authorized under section 13(3) of the Federal Reserve Act: the Main Street New Loan Facility (the **New Facility**) and the Main Street Expanded Loan Facility (the **Expanded Facility** and, collectively with the New Facility, the **Main Street Facilities**). The New Facility seeks to make available new loans to Eligible Borrowers and the Expanded Facility seeks to facilitate increases to Eligible Borrowers' existing credit facilities through additional upsized tranches. As detailed below, the primary differences between the two facilities are the required collateral and the maximum loan size. The restrictions and features of the Main Street Facilities are otherwise similar.

The Main Street Facilities will be structured as a commitment to lend by the Federal Reserve on a recourse basis to a single common special purpose vehicle (the **SPV**) that will purchase on or before September 30, 2020 (unless such date is subsequently extended) 95 percent participations in Eligible Loans from Eligible Lenders (with Eligible Lenders retaining 5 percent of each Eligible Loan).

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) employ less than 10,000 employees *or* have 2019 annual revenues of less than $2.5 billion;

(b) be created or organized in the United States or under the laws of the United States with significant operations in the United States; and

(c) have a majority of its employees based in the United States.

Eligible Borrowers may only participate in one of the New Facility or the Expanded Facility but not both. The Main Street Facilities will be available to businesses that have participated in the Paycheck Protection Program but businesses may not also participate in the Federal Reserve's Primary Market Corporate Credit Facility (purchases of bonds from and loans to investment grade eligible businesses). The Main Street Facilities are separate and distinct from the Paycheck Protection Program, and the applicable Small Business Administration rules and regulations concerning borrower eligibility and other terms and conditions do not apply to the Main Street Facilities. As a result, it appears that otherwise eligible private equity backed portfolio companies, venture capital backed companies and the US holding and operating companies of international conglomerates or joint ventures should not be disqualified from participating based on their ownership and governance structures, as is often the case under the rules governing the Paycheck Protection Program.[1]

Eligible Lenders under the Main Street Facilities are US insured depository institutions, US bank holding companies and US savings and loan holding companies. The limitation to US bank entities may create difficulties for Eligible Borrowers having existing credit facilities with one or more non-US lenders or nonbank lenders as they seek to participate in the Expanded Facility.

Economic Terms of Eligible Loans

Eligible Loans under the Main Street Facilities must contain the following features:

(a) four-year maturity;

(b) deferral of amortization of principal and interest for one year from origination;

(c) adjustable interest rate of the Secured Overnight Financing Rate plus 250–400 basis points;

(d) an origination fee equal to 100 basis points of the principal amount of the Eligible Loan (for loans made under the Expanded Facility, this fee would be calculated based upon the amount of the upsized tranche only);

(e) prepayment is permitted without penalty; and

(f) minimum loan size of $1 million.

Eligible Loans under the New Facility will be unsecured term loans, while the upsized tranche of any Eligible Loans under the Expanded Facility will be secured on a pro rata basis with respect to any collateral securing the entire Eligible Loan (whether pledged under the original terms or at the time of upsizing).

The maximum upsized tranche that can be added to existing loans as an Eligible Loan under the Expanded Facility is an amount equal to the lesser of:

(a) $150 million;

(b) 30 percent of the Eligible Borrower’s existing outstanding and committed but undrawn bank debt; or

(c) an amount that, when added to the Eligible Borrower’s existing outstanding and committed but undrawn debt, does not exceed <u>six</u> times the Eligible Borrower’s 2019 EBITDA.

The maximum new loan size for Eligible Loans under the New Facility is an amount equal to the lesser of:

(a) $25 million; or

(b) an amount that, when added to the Eligible Borrower’s existing outstanding and committed but undrawn debt, does not exceed <u>four</u> times the Eligible Borrower’s 2019 EBITDA.

[1] If no changes or clarifications are made to modify this interpretation, this would mean that the restrictions placed on Eligible Borrowers as outlined below (with the exception of the restrictions on stock buybacks and the conflict of interest restrictions) would only apply to the Eligible Borrower and operations/entities controlled by the Eligible Borrower and not the Eligible Borrower’s direct or indirect equity holders.

Note that many borrowers use “adjusted” EBITDA (which includes add-backs and other adjustments to actual EBITDA) in reporting under existing credit agreements, and the Federal Reserve’s term sheets do not address whether these adjustments will be used in the calculation of the EBITDA leverage condition applicable to its Eligible Loan.

Eligible Lenders under the New Facility will also have to pay a “facility fee” equal to 100 basis points of the amount of the Eligible Loan purchased by the SPV (the SPV is expected to purchase 95 percent of the Eligible Loan value and the “facility fee” would be determined using this amount) and can pass this cost on to Eligible Borrowers.

Section 4003(d)(3) of the CARES Act expressly provides that the principal amount of Eligible Loans pursuant to the Main Street Facilities may not be reduced through loan forgiveness.

Restrictions and Conditions

In addition to certain required Eligible Lender attestations, the Main Street Facilities require Eligible Borrowers to agree to certain restrictions as a condition to receiving loans under the programs. Eligible Loans may only be purchased under the Main Street Facilities if the Eligible Borrower agrees to:

(a) attest that it requires financing due to exigent circumstances presented by the COVID-19 pandemic and that, using the proceeds of the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility), the Eligible Borrower will make reasonable efforts to maintain its payroll and retain its employees during the term of the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility);

(b) attest that it will refrain from using the proceeds of the Eligible Loan (or upsized tranche thereof with respect to the Expanded Facility) to repay other loan balances (including, in the case of the Expanded Facility, the pre-existing portion of the Eligible Loan);

(c) attest that it will refrain from repaying other debt of equal or lower priority, with the exception of mandatory principal payments, unless the Eligible Loan has been paid in full;

(d) attest that it will not seek to cancel or reduce any of its outstanding lines of credit with any lender, including the Eligible Lender under the applicable Main Street Facility;

(e) attest that it meets the EBITDA leverage condition applicable to its Eligible Loan (as described above);

(f) 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;

(g) 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 has been paid in full;

(h) comply with the employee compensation limits set forth in Section 4004 of the CARES Act (discussed below); and

(i) certify that it is eligible to receive the Eligible Loan (or upsized tranche thereof with respect to the Expanded 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, accommodate required repayment restrictions upon outstanding loans prior to the repayment in full of any Eligible Loans and address the yet unspecified amortization requirements of Eligible Loans under the Main Street Facility following the initial one-year deferral period.

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 percent 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 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 percent 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-sized 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.

Next Steps

As of publication, additional details of the Main Street Facilities are still being finalized. The Federal Reserve has encouraged input from lenders, borrowers and other stakeholders through an online feedback form that will be open until April 16. Potential borrowers should contact their existing lenders and bankers regarding the availability of the Main Street Facilities.

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