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Client Alert: Federal Reserve Announces Expansion, Changes to Main Street Lending Program

This Client Alert serves to update and supplement our Client Alert of April 9, 2020,[1] in light of additional guidance issued by the Board of Governors of the Federal Reserve System. Note, the Board of Governors and the Secretary of the Treasury may make further adjustments to the Main Street Lending Program in the future, as the Program has not yet been finalized.

Executive Summary

On April 30, 2020, the Board of Governors of the Federal Reserve System (the "**Fed**") announced a series of revisions to, as well as an additional facility under, its previously-announced $600 billion Main Street Lending Program.[2] With this announcement, the Fed created a third loan facility, the Main Street Priority Loan Facility (the "**MS Priority Facility**"), which is targeted at borrowers with greater leverage, and supplements the Main Street Expanded Loan Facility (the "**MS Expanded Facility**") and the Main Street New Loan Facility (the "**MS New Facility**"; together with the MS Priority Facility and the MS Expanded Facility, the "**Main Street Facilities**"). The Fed revised the overall Main Street Lending Program in response to over 2,200 comments that it received to prior iterations of the MS New Facility and the MS Expanded Facility term sheets issued by the Fed on April 9, 2020. The comments generally requested changes to make the facilities available to a broader range of business, to use an adjusted Earnings before Interest, Taxes, Depreciation, and Amortization ("EBITDA") metric, as it is more common in the U.S. commercial loan market, as opposed to the use of EBITDA, and the use of London Interbank Offered Rate ("LIBOR") pricing as opposed to Secured Overnight Financing Rate ("SOFR"), which the Fed has been encouraging markets to adopt as a replacement for LIBOR, upon the anticipated phase-out of LIBOR at the end of 2021.[3]

The key takeaways from the Fed's current announcement, in addition to the creation of the MS Priority Facility, are as follows:

- *Replaced* the adjustable rate based on SOFR with LIBOR plus 3%, for all of the Main Street Facilities.
- *Reduced* the minimum loan size for the MS New Facility and the MS Priority Facility from $1 million to

$500,000, while adjusting the maximum loan size for the MS Expanded Facility to $200 million.
- *Increased* the maximum borrower size to include borrowers who either (i) employ 15,000 or fewer individuals or (ii) earned $5 billion or less in 2019 annual revenues for all of the Main Street Facilities.
- *Defined* the repayment terms for all of the Main Street Facilities, including a deferral of the first year of payments of both principal and interest for all borrowers under the Main Street Facilities.
- *Expanded* the scope of eligible lenders to include savings associations, credit unions, U.S. branches of foreign banks, and U.S. intermediate holding companies of foreign banking organizations, including their U.S. subsidiaries.

While the Fed still has yet to announce a start date for the Program, it did release frequently-asked questions and answers (the "FAQs") based on the public comment the Fed received following the Program's initial announcement.[4] Additionally, the Fed indicated that it will release further information on the Program's credit administration and loan servicing through its website.

<u>Borrower Eligibility Criteria</u>

The Fed harmonized many of the borrower eligibility requirements across the Main Street Facilities, to include the following:

1. <u>"Business"</u>: A borrower must be an entity organized for profit, such as a partnership, a limited liability company, a corporation, an association, a trust, a cooperative, a joint venture with no more than 49% participation by foreign business entities, or a tribal business concern, as defined in the Small Business Act.[5]
2. <u>Existence</u>: A borrower must have been established prior to March 13, 2020.
3. <u>Size</u>: A borrower must either (i) employ 15,000 or fewer individuals or (ii) have earned $5 billion or less in 2019 annual revenues.
4. <u>Domestic</u>: A borrower must be created or organized in the United States, or under the laws of the United States with significant operations and a majority of its employees based in the United States.
5. <u>Employees</u>: A borrower must make reasonable efforts to maintain its payroll and retain employees during the term of its Main Street Facility. This means good-faith efforts to maintain payroll and retain employees, in light of the borrower's capacities and available resources, the economic environment and the business need for labor.[6]

The Fed also clarified a few of the negative restrictions on borrower eligibility, including the following:

1. <u>"Ineligible Business"</u>: A borrower cannot be considered an "ineligible business." The Fed has adopted certain of the Small Business Administration's ("**SBA**") regulations on Section 7(a) loan participation to determine the categories of excluded borrowers.[7] At this time, the Fed has not stated whether it intends to also adopt the SBA's standardized exceptions to these eligibility restrictions, which leaves room for development.[8]
2. <u>Programmatic Limitations</u>: A borrower cannot simultaneously participate in each of the Main Street Facilities, to include the Fed's Primary Market Corporate Credit Facility.[9] However, a borrower may be able to borrow multiple times under one of the Facilities. Moreover, a borrower who received a Paycheck Protection Program ("**PPP**") loan is <u>not</u> automatically ineligible to participate in the Main Street Facilities.

Additionally, the Fed has clearly indicated that non-profit organizations are not currently eligible for participation in the Main Street Lending Program, primarily as a result of the fact that non-profits are generally not evaluated on an EBITDA metric. However, the Fed and the U.S. Department of the Treasury ("**Treasury**") will be evaluating in the future potential modifications that might allow nonprofits to participate in the Main Street Lending Program.[10]

Eligible Loans under the Main Street Facilities

The Fed provided additional information on the basic terms of each of the Main Street Facilities, which are summarized in the chart below.

	MS New Facility	MS Priority Facility	MS Expanded Facility
Term	Four Years	Four Years	Four Years
Interest Rate	LIBOR + 3%	LIBOR + 3%	LIBOR + 3%
Payment Schedule	Y1: Deferred Y2: 33.33% of Principal Y3: 33.33% of Principal Y4: 33.33% of Principal	Y1: Deferred Y2: 15% of Principal Y3: 15% of Principal Y4: 70% of Principal	Y1: Deferred Y2: 15% of Principal Y3: 15% of Principal Y4: 70% of Principal
Prepayment	Without Penalty	Without Penalty	Without Penalty
Fed Participation	5%	15%	5%
Minimum Size	$500,000	$500,000	$10,000,000
Maximum Size	Lesser of: (i) $25,000,000; and (ii) Four times 2019 adjusted EBITDA	Lesser of: (i) $25,000,000; and (ii) Six times 2019 adjusted EBITDA	Lesser of: (i) $25,000,000; (ii) 35% of existing outstanding and undrawn available debt; and (iii) Six times 2019 adjusted EBITDA

In addition to the above, an eligible loan may be a secured or unsecured term loan or, in the case of a loan under the MS Expanded Facility only, a revolving credit facility; *provided*, that if the existing tranche of a MS Expanded Facility loan is secured, the upsized tranche must also be secured. Also, any existing loan that a borrower maintained with its Main Street Facility lender, including an upsized loan, must have received an internal risk rating, based on the lender's risk rating system, equivalent to a "pass" on the Federal Financial Institutions Examination Council's supervisory rating system, as of December 31, 2019.

The Fed also revised the origination dates for eligible loans, as follows:

- *For the MS New Facility*, an eligible loan must be originated after April 24, 2020.
- *For the MS Priority Facility*, an eligible loan must be originated after April, 24, 2020. Notably, an eligible loan under the MS Priority Facility may be a refinancing of an existing debt owed by the borrower to someone other than the MS Priority Facility lender.
- *For the MS Expanded Facility*, an eligible loan must have been originated on or before April 24, 2020, with a remaining maturity of at least 18 months, taking into account any adjustments made to the maturity date after April 24, 2020, including at the time of upsizing.

Borrower's Covenants and Certifications

The Fed further detailed the covenants and certifications that would be required under the Main Street

Facilities, as well as the lender's role in the process. For example, an eligible borrower must commit to (i) refrain from repaying any principal or interest on any debt other than the Main Street Facility loan, unless the debt is mandatory and due, until the Main Street Facility is repaid in full and (ii) follow the compensation, stock repurchase, and capital distribution requirements applicable to direct loans under section 4003(c)(3)(A)(ii) under the CARES Act, with the exception of certain necessary tax distributions for pass-through entities.[11] The Borrower must also certify that it has a reasonable basis to believe that, as of the date on which it receives its Main Street Facility loan and after giving effect to such loan, the borrower will have the ability to meet its financial obligations for the next 90 days and does not expect to file for bankruptcy during those 90 days.

Similar to the lender's role under the SBA's PPP, a lender under the Main Street Facilities is not required to independently verify the borrower's certifications as to its status as an eligible borrower under the Main Street Lending Program, nor is the lender required to actively monitor the borrower's ongoing compliance as an eligible borrower for participation in the Main Street Facilities. Moreover, the lender can rely on a borrower's initial certification and covenants, as well as any subsequent self-reporting. However, the lender is required to collect the certification and covenants at the time of the loan's origination, and the Fed recognized that in determining a borrower's financial condition and creditworthiness, the lender will be expected to apply its own underwriting standards, which may require the lender to request additional information and documentation from the borrower.

Lender's Fees and Additional Information

The Fed has also clarified the fees to be charged and collected in connection with making a loan under the Main Street Facilities, which are summarized in the chart below.

At the time of loan origination, the lender will pay the Fed's special purpose vehicle ("SPV") the transaction fee, which the lender may collect from the borrower. At the same time, the borrower will pay the lender the origination fee. The SPV will then pay the annual servicing fee to the lender based on the SPV's participation interest in the underlying loan.

The Fed has advised lenders that it will be releasing on its website the documentation required to sell eligible loan participations to the Fed's SPV. Prior to purchase, the SPV will collect ordinary loan-related information, such as the loan terms, the borrower's fundamentals and financials, the certification and covenants, loan performance, and any collateral. Note, the Fed has also stated that apart from the Program's $600 billion size and expected deadline of September 30, 2020, it will place no limit on the number or amount of participations the SPV will purchase from a single eligible lender.

Applications

As noted above, the Fed has not released the final details or application process for the Main Street Facilities. We expect that the Fed will continue to release additional information on the Program through its website, as it has done in the past.

About Shumaker

Shumaker's Financial Services practice group has extensive experience in representing both financial institutions and commercial borrowers in a variety of transactions and structures, in all areas of commercial lending. We are monitoring the status and progression of the Main Street Facilities and are prepared to advise clients on loan application process as the Program details are finalized. Please contact us if you have questions regarding this Client Alert or if we can be of assistance in reviewing loan documentation and advising of potential courses of action.

[1] Shumaker, Loop & Kendrick, LLP, *Client Alert: Federal Reserve System Announces Main Street Loan Facilities to Support Small and Medium-Sized Businesses* (Apr. 9, 2020), https://www.shumaker.com/latest-thinking/publications/2020/04/client-alert-federal-reserve-system-announces-main-street-loan-facilities-to-support-small-and-medium-sized-businesses.

[2] Press Release, Board of Governors of the Federal Reserve System, *Federal Reserve Board announces it is expanding the scope and eligibility for the Main Street Lending Program* (Apr. 30, 2020, 10:00 AM), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200430a.htm [hereinafter the Fed Press Release].

[3] *See* Shumaker, Loop & Kendrick, LLP, *Client Alert: What to do about the Libor Time Bomb? ARRC Adopts Recommended Fall-Back Language for Libor Based Credit Facilities* (May 14, 2019), https://www.shumaker.com/latest-thinking/publications/2019/05/client-alert-what-to-do-about-the-libor-time-bomb-arrc-adopts-recommended-fall-back-language-for-libor-based-credit-facilities.

[4] *Main Street Lending Program: Frequently Asked Questions*, Board of Governors of the Federal Reserve System (Apr. 30, 2020), https://www.federalreserve.gov/monetarypolicy/files/main-street-lending-faqs.pdf. Like the Fed Press Release, the FAQs are subject to change at the Fed's discretion.

[5] In the FAQs, the Fed noted that its definition of "business" would exclude nonprofit organizations and explained that it would be working with the Secretary of the Treasury to determine whether a lending program could be developed to serve the needs of such entities.

[6] In the FAQs, the Fed clarifies that businesses which have furloughed or laid-off employees prior to receiving financing under the Main Street Facilities are still eligible for such financing.

[7] *See* 13 C.F.R. § 120.110(b)–(j), (m)–(s).

[8] *See* Standard Operating Procedure 50 10 5(K), Small Business Administration (Apr. 1, 2019), https://www.sba.gov/sites/default/files/2019-02/SOP%2050%2010%205%28K%29%20FINAL%202.15.19%20SECURED%20copy%20paste.pdf.

[9] A borrower is also ineligible if it has received specific, direct loan support under section 4003(b)(1)–(3) of the Coronavirus Economic Stabilization Act of 2020 (the "CARES Act"), which dealt with loans to certain distressed businesses in the airplane transportation and national security industries.

[10] *See* FAQ E.6.

[11] In the FAQs, the Fed clarified that paying down ordinary business lines of credit, such as credit cards, paying or incurring debt obligations required in the ordinary course of business and refinancing maturing debts would not violate the covenant under clause (i), above.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource & Return-to-Work Guide at shumaker.com. To receive the latest news and updates regarding COVID-19 straight to your inbox, sign up here.

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