

Legal Update

U.S. Federal Reserve Expands and Provides Additional Details on Main Street Lending Program for Small and Mid-Sized Businesses

On April 30, 2020, the Federal Reserve Board announced expanded loan offerings and terms for the forthcoming Main Street Lending Program.¹ Originally unveiled on April 9, the program is designed to provide assistance to firms that are too large to qualify for the Small Business Administration's (SBA) Paycheck Protection Program (PPP) (although borrowers that receive loans under the PPP are not disqualified from the Main Street Lending Program), not large enough to access corporate debt markets, and not eligible for the Federal Reserve's lending facilities for investment-grade companies.²

As revised, the Main Street Lending Program is now open to larger businesses with up to 15,000 employees or \$5 billion in 2019 annual revenue (previously up to 10,000 employees or \$2.5 billion in 2019 annual revenue). The minimum size of certain loans was also reduced to \$500,000 from \$1 million to help provide assistance to smaller businesses.

The revised terms incorporate several refinements proposed by stakeholders, such as changing the reference rate from SOFR to LIBOR and permitting EBITDA to be calculated on an adjusted basis. The new terms also provide clarity on eligibility requirements for borrowers and lenders. However, the revised program retains several terms and conditions that were not viewed favorably by some prospective participants, including the underwriting and risk-sharing structure for lenders and restrictive covenants and commitments required of borrowers. The revised terms also impose additional borrower eligibility requirements that may prevent certain types of companies from obtaining Main Street loans, including certain finance companies, life insurance companies, private equity funds (and their portfolio companies), and hedge funds.

This Legal Update provides an overview of the Federal Reserve's revisions to the Main Street Lending Program. A forthcoming Mayer Brown Legal Update will provide detailed analysis of these revised terms and conditions and the implications for lenders and prospective borrowers in various industries.

Highlights of Revised Program

The overall structure of the revised Main Street Lending Program is generally consistent with the structure outlined in the initial April 9 announcement. The largest changes are the expanded scope of

the program, the addition of a third lending facility, and the incorporation of the affiliation and ineligible business concepts from the PPP, but many smaller yet substantive changes and clarifications will also shape how the program is administered and which companies will be eligible. The following sections summarize several of the most significant changes.

LARGER COMPANIES NOW ELIGIBLE TO PARTICIPATE, BUT MUST COUNT “AFFILIATES”

The initial program terms limited eligibility to companies with either fewer than 10,000 employees or less than \$2.5 billion in 2019 annual revenue. The revised terms now allow companies to be eligible if they have fewer than 15,000 employees or less than \$5 billion in 2019 annual revenue. However, the revised terms clarify that the employees and revenue of a company must be aggregated with the employees and revenues of its affiliated entities using the SBA’s affiliation rules (the same rules applied for the PPP, with certain exceptions). These rules generally require companies to aggregate their employees and revenues of their parent companies and other commonly controlled companies. This may result in some companies, particularly companies controlled by private equity funds that also own other portfolio companies, being deemed too large to be eligible for the program.

NEW “PRIORITY LENDING FACILITY”

As originally announced, the Main Street Lending Program envisioned two facilities: the Main Street New Loan Facility (“MSNLF”) for new loans and the Main Street Expanded Loan Facility (“MSELF”) for upsized tranches of existing loans.

The program will now also include a third facility, the Main Street Priority Loan Facility (“MSPLF”). Like the MSNLF, the MSPLF will purchase participations in eligible new loans. However, the MSPLF will allow lenders to originate new loans to borrowers with greater leverage than permitted under the MSNLF if the lenders retain a greater interest in the loan (15% versus 5%). At the time of origination and at all times thereafter, the MSPLF loan must be senior to or *pari passu* with, in terms of priority and security, the borrower’s other loans or debt instruments (other than mortgage debt), which is likely to create challenges for many companies that would need the consent of their existing creditors to grant *pari passu* liens to secure the MSPLF loan and potentially negotiate intercreditor arrangements. Helpfully, at the time of origination of the loan, borrowers may refinance existing debt owed by the borrower to a lender other than the lender for the MSPLF loan.

ADDITIONAL BORROWER ELIGIBILITY REQUIREMENTS

The revised terms impose additional borrower eligibility requirements that were not included in the initial program terms. These new restrictions link borrower eligibility for the Main Street Lending Program to some of the same SBA rules and regulations that govern the PPP, including the SBA’s “Ineligible Business” regulations (as well as the affiliation rules described above). As incorporated into Main Street, these “Ineligible Business” regulations may prevent certain types of businesses from being eligible for the Main Street Lending Program, including certain finance companies, life insurance companies, private equity firms, and hedge funds.

NO RELIEF FROM RESTRICTIONS AND CONDITIONS ON BORROWERS

The restrictions and conditions on borrowers included in the initial terms and conditions are largely unchanged. As with the initial program terms, borrowers must agree to the compensation, stock repurchase, and dividend restrictions that apply to direct loan programs under Title IV of the CARES Act. However, the revised guidance does clarify that the restrictions on dividends and other capital

distributions will not apply to distributions made by an S corporation or other tax pass-through entity to the extent reasonably required to cover its owners' tax obligations in respect of the entity's earnings.

Borrowers seeking Main Street loans must commit to make "reasonable efforts" to maintain payroll and retain workers but are not required to maintain specific levels (as is required for forgiveness under the PPP). The revised guidance does not provide much additional clarity on the meaning of "reasonable efforts," defining the phrase as "good-faith efforts to maintain payroll and retain employees, in light of [the borrower's] capacities, the economic environment, its available resources, and the business need for labor." However, the guidance does clarify that companies that have already laid off or furloughed workers as a result of the disruptions from COVID-19 are still eligible to apply for Main Street loans.

LOANS ORIGINATED BY BANKING ORGANIZATIONS ONLY

The loans for all three facilities will be originated through "Eligible Lenders," which include U.S. federally insured depository institutions, their U.S. holding companies, and their non-bank subsidiaries. The revised guidance clarifies that U.S. branches or agencies of foreign banks and U.S. intermediate holding companies of foreign banking organizations are eligible to participate. At this time, nonbank financial institutions (including credit funds) are not considered "Eligible Lenders," but the Federal Reserve indicated that it is considering options to expand the scope of eligibility in the future.

LENDERS BEAR UNDERWRITING BURDEN

Unlike the SBA with the PPP, the Federal Reserve has determined that the eligibility criteria for the Main Street Lending Program are to be treated as "minimum requirements" and that the final underwriting decision ultimately falls to the lender.

To meet the Main Street Lending Program's "minimum requirements," borrowers must have been in "sound financial condition" prior to the onset of the COVID-19 pandemic, meet the loan facility's EBITDA requirement, and certify that they have a "reasonable basis" to believe that they have the ability to meet their financial obligations for at least the next 90 days and do not expect to file for bankruptcy during that time period.

However, even if these requirements are met, borrowers must also meet the lender's own underwriting requirements, which may exceed those imposed by the Federal Reserve. Lenders are expected to assess each potential borrower's financial condition and apply their own underwriting standards to evaluate the borrower's creditworthiness. Given that lenders are required to retain a portion of the loans (5% under the MSNLF and MSELF and 15% under the MSPLF), lenders would likely be incentivized to do so in any event. As a result, it is possible that businesses that otherwise meet the borrower eligibility requirements still may not be approved for a loan (or not receive the maximum allowable amount) based on the lender's own underwriting criteria.

CHANGE TO LIBOR FROM SOFR

Even though firms cannot rely on LIBOR being published after the end of 2021, the Federal Reserve acknowledged that LIBOR remains the most common reference rate used in business lending and that lenders may not be ready from an operational and documentation perspective to make loans based on SOFR and changed the reference rate for Main Street loans from SOFR to LIBOR. However, the Federal Reserve's guidance instructs borrowers and lenders to include fallback contract language to be used should LIBOR become unavailable during the term of the loan.

AMORTIZATION AND PAYMENT SCHEDULE

The revised terms now specify a payment schedule for loans through each of the three Main Street facilities. No payments of principal or interest will be required during the first 12 months of any Main Street loan, but unpaid interest will be capitalized. The loan will be amortized over the remaining term of the loan. For the MSNLF, one-third of the principal will be due at the end of each of years two and three, and the remaining one-third will be due at maturity at the end of year four. For the MSPLF and MSELF, 15% of the principal will be due at the end of year two; 15% at the end of year three; and a balloon payment of 70% at maturity at the end of year four. These maturity and amortization requirements may be issues for some borrowers whose existing debt documentation would not permit them to incur debt with these features.

INFORMATION ON PARTICIPANTS WILL BE DISCLOSED

The Federal Reserve confirmed that it will disclose information regarding the MSNLF, MSPLF, and MSELF during the operation of the facilities, including names of lenders and borrowers, amounts borrowed, and interest rates charged and overall costs, revenues, and other fees. These disclosures are in addition to, and separate from, periodic disclosures to Congress that are required for all Federal Reserve programs.

Summary of Terms, Conditions, and Other Requirements

The Main Street Lending Program’s three facilities use the same “Eligible Lender” and “Eligible Borrower” criteria and have many of the same features, including the same maturity, interest rate, deferral of principal and interest for one year, and ability of the borrower to prepay without penalty. Other features of the loans extended in connection with each facility differ. The loan types also differ in how they interact with the borrower’s existing outstanding debt.

The table below summarizes the terms, conditions, and other requirements for each of the three Main Street Lending Program facilities as revised.

	NEW LOANS	PRIORITY LOANS	EXPANDED LOANS
Eligible Lender Requirements	<ul style="list-style-type: none"> • U.S. federally insured depository institutions (e.g. bank, savings association, credit union) • U.S. branch/agency of foreign bank • U.S. bank holding company • U.S. savings and loan holding company • U.S. intermediate holding company of a foreign banking organization • any U.S. subsidiary of the above 		
Eligible Borrower Size Requirements	No more than: <ul style="list-style-type: none"> • 15,000 employees; or • \$5 billion of 2019 revenues 		
Type	Term Loan	Term Loan	Term Loan or Revolving Credit Facility, each with a remaining maturity of at least 18 months
Secured Status	Secured or Unsecured		

	NEW LOANS	PRIORITY LOANS	EXPANDED LOANS
Term	4 years		
Minimum Loan Size	\$500,000	\$500,000	\$10,000,000
Maximum Loan Size	Lesser of: <ul style="list-style-type: none"> • \$25M; or • 4x Eligible Borrower's 2019 adjusted EBITDA 	Lesser of: <ul style="list-style-type: none"> • \$25M; or • 6x Eligible Borrower's 2019 adjusted EBITDA 	Lesser of: <ul style="list-style-type: none"> • \$200M; • 35% of outstanding and undrawn available <i>pari passu</i> debt with same secured status; or • 6x 2019 adjusted EBITDA
Subordination	Eligible Loan not to be contractually subordinated (in terms of priority) to any other debt of the Eligible Borrower.	Eligible Loan to be senior or <i>pari passu</i> (in terms of priority and security) with Eligible Borrower's other debt (other than mortgage debt).	Upsized tranche of Eligible Loan to be senior or <i>pari passu</i> (priority and security) with Eligible Borrower's other debt (other than mortgage debt).
Loan Participations	SPV will purchase a 95% participation in Eligible Loan as a "true sale" after closing.	SPV will purchase a 85% participation in Eligible Loan as a "true sale" after closing.	SPV will purchase a 95% participation in upsized tranche of Eligible Loan as a "true sale" after closing.
Risk Retention	Eligible Lender must hold 5% of Eligible Loan until Eligible Loan matures or SPV sells all of its participation.	Eligible Lender must hold 15% of Eligible Loan until Eligible Loan matures or SPV sells all of its participation.	Eligible Lender must be one of the lenders (but need not be the only lender) that holds an interest in the underlying Eligible Loan. Eligible Lender must hold 5% of upsized tranche of Eligible Loan, and its interest in the existing Eligible Loan, until upsized tranche matures or SPV sells all of its participation.
Amortization	<ul style="list-style-type: none"> • Year 1: N/A • Year 2: 33.33% • Year 3: 33.33% • Year 4: 33.33% 	<ul style="list-style-type: none"> • Year 1: N/A • Year 2: 15% • Year 3: 15% • Year 4: 70% 	<ul style="list-style-type: none"> • Year 1: N/A • Year 2: 15% • Year 3: 15% • Year 4: 70%
Benchmark Rate	LIBOR (1 or 3 months)		
Margin	3.00%		

	NEW LOANS	PRIORITY LOANS	EXPANDED LOANS
Prepayment	No penalty		
Key Eligible Lender Certifications and Covenants	<ul style="list-style-type: none"> • Eligible Lender shall not request early repayment of any other debt from Eligible Borrower. • Eligible Lender shall not cancel or reduce any other committed line of credit to the Eligible Borrower (except following an Event of Default). • Eligible Lender to certify methodology used to calculate 2019 EBITDA is the same as previously used for Eligible Borrower (or similarly situated borrowers in the case of New Loans and Priority Loans). 		
Key Eligible Borrower Certifications and Covenants	<ul style="list-style-type: none"> • Eligible Borrower shall not make any prepayment of other debt (in case of Priority Loans, Eligible Borrower may refinance existing debt owed by the Eligible Borrower to a different lender concurrently with closing). • Eligible Borrower shall not cancel or reduce any other committed lines of credit. • Eligible Borrower to certify it has reasonable basis to believe that it has the ability to meet its financial obligations for 90 days following closing. • Eligible Borrower to follow compensation, stock repurchase, and capital distributions restrictions applicable to section 4003(c)(3)(A)(ii) of the CARES Act. 		
Retention of Employees	Eligible Borrower to make "commercially reasonable efforts" to maintain its payroll and retain employees while Eligible Loan (or upsized tranche of Eligible Loan, in case of Expanded Loans) is outstanding.		
Fees	<ul style="list-style-type: none"> • Transaction Fee: 1.00% • Origination Fee: 1.00% • Servicing Fee: 0.25% of SPV's participation (to be paid by SPV to Eligible Lender) 	<ul style="list-style-type: none"> • Transaction Fee: 1.00% • Origination Fee: 1.00% • Servicing Fee: 0.25% of SPV's participation (to be paid by SPV to Eligible Lender) 	<ul style="list-style-type: none"> • Transaction Fee: 0.75% of upsized tranche • Upsizing Fee: 0.75% of upsized tranche • Servicing Fee: 0.25% of SPV's participation (to be paid by SPV to Eligible Lender)
Program Termination	SPV to purchase participations in Eligible Loans until September 30, 2020, unless extended by the Department of the Treasury.		

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And for any legal questions related to this pandemic, please contact the authors of this Legal Update or Mayer Brown's COVID-19 Core Response Team at FW-SIG-COVID-19-Core-Response-Team@mayerbrown.com.

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Endnotes

¹ Federal Reserve, Federal Reserve Board announces it is expanding the scope and eligibility for the Main Street Lending Program (Apr. 30, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200430a.htm>

² For analysis of the Main Street Lending Program's initial terms, see Mayer Brown's Legal Update *U.S. Federal Reserve Announces Main Street Lending Program to Provide Financing to Small and Mid-Sized Businesses* (April 10, 2020), <https://www.mayerbrown.com/en/perspectives-events/publications/2020/04/us-federal-reserve-announces-main-street-lending-program-to-provide-financing-to-small-and-midsized-businesses>. More information on the programs available for large employers and small businesses can be found in the following Mayer Brown publications: *US Treasury and Federal Reserve Announce Two New Corporate Credit Facilities for Large Employers* (Mar. 25, 2020), <https://www.mayerbrown.com/en/perspectives-events/publications/2020/03/us-treasury-and-federal-reserve-announce-two-new-corporate-credit-facilities-for-large-employers>; *Federal Reserve launches commercial paper funding facility* (Mar. 24, 2020), <https://covid19.mayerbrown.com/government-federal-reserve-launches-commercial-paper-funding-facility/>; *Legal Update on Section 4003 of the CARES Act – Liquidity for Eligible Businesses, States, and Municipalities* (Mar. 31, 2020), <https://www.mayerbrown.com/en/perspectives-events/publications/2020/03/legal-update-on-section-4003-of-the-cares-act-liquidity-for-eligible-businesses-states-and-municipalities>.

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