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Alerts

The Federal Reserve Releases Details on Two New Main Street Loan Facilities and the Paycheck Protection Program Loan Facility

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Hinshaw Alert

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In a recent alert, we reviewed a series of developments regarding implementation of the $2.2 trillion federal CARES Act, including news that the Federal Reserve had released details on two new loan facilities. This alert considers these new loan facilities in greater detail.

On April 9, the Federal Reserve released details on three loan facilities: (i) the Main Street New Loan Facility (the "Facility"); (ii) the Main Street Expanded Loan Facility (the "Expanded Facility"); and (iii) the Paycheck Protection Program Loan Facility.

Under the Facility and the Expanded Facility, a Federal Reserve Bank ("Reserve Bank") will commit to lend to a single common special purpose vehicle ("SPV") on a recourse basis. The SPV will purchase 95% participations in Eligible Loans from Eligible Lenders. Eligible Lenders will retain 5% of each Eligible Loan.

The Department of the Treasury will make a $75 billion equity investment in the SPV in connection with the Facility and the Expanded Facility. The combined size of the Facility and the Expanded Facility will be up to $600 billion.

The Federal Reserve and Secretary of the Treasury may make adjustments to the terms and conditions described in this client alert. Any changes will be announced on the Board's website.

The program will provide an excellent opportunity for middle market companies to secure badly needed financing. However, the program's success will depend almost entirely on the willingness of Eligible Lenders to make the loans to the middle market companies. Further, it does pose problems for a number of middle market companies, because the Facility currently provides that companies with debt in excess of four times the earnings before interest, taxes, depreciation, and amortization ("EBITDA") will not be able to participate. The Expanded Facility allows middle market companies access to a larger maximum loan amount.

1. The Main Street New Loan Facility

Eligible Lenders

Eligible Lenders are U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies.

Eligible Borrowers

Any business with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues created or organized in the United States, or under the laws of the United States, is eligible to participate. However, the business must have significant operations in—and a majority of its employees based in—the United States.

Eligible Borrowers that participate in the Facility cannot also participate in the Expanded Facility or the Primary Market Corporate Credit Facility (another Federal Reserve program).

Eligible Loans

An Eligible Loan is an **unsecured term loan** made by an Eligible Lender(s) to an Eligible Borrower that was originated **on or after April 8, 2020**, provided that the loan has the following features:

1. Four year maturity;
2. Amortization of principal and interest deferred for one year;
3. Adjustable rate of SOFR + 250-400 basis points;
4. Minimum loan size of $1 million;
5. 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 committed but undrawn debt, does not exceed four times the Eligible Borrower's 2019 EBITDA; and
6. Prepayment permitted without penalty.

Loan Participations

The SPV will purchase from an Eligible Lender a 95% participation in an Eligible Loan at par value, and the Eligible Lender will retain 5% of the Eligible Loan. The SPV and the Eligible Lender will share risk on a *pari passu* basis.

Required Attestations From Eligible Borrowers

An Eligible Borrower will be required to make attestations for each Eligible Loan for which the SPV acquires an interest. In the attestations, each Eligible Borrower must:

- Commit to refrain from using the proceeds of the Eligible Loan to repay other loan balances;
- Commit to refrain from repaying other debt of equal or lower priority, with the exception of mandatory principal payments, unless the Eligible Borrower has first repaid the Eligible Loan in full;
- Attest that it requires the financing due to the exigent circumstances presented by the COVID-19 crisis, and that, using the proceeds of the Eligible Loan, it will make reasonable efforts to maintain its payroll and retain its employees during the term of the Eligible Loan;
- Attest that it will not seek to cancel or reduce any of its outstanding lines of credit with the Eligible Lender or any other lender;
- Attest that it meets the EBITDA leverage condition stated in section 5(ii) of the paragraph above specifying required features of Eligible Loans;

- Attest that it will follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act (and discussed below); and
- Certify that it is eligible to participate in the Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act (and discussed below).

Required Attestations From Eligible Lenders

An Eligible Lender will be required to make attestations for each Eligible Loan in which the SPV acquires an interest. In the attestations, each Eligible Lender must:

- Attest that the proceeds of the Eligible Loan will not be used to repay or refinance pre-existing loans or lines of credit made by the Eligible Lender to the Eligible Borrower;
- Attest that it will not cancel or reduce any existing lines of credit outstanding to the Eligible Borrower; and
- Certify that it is eligible to participate in the Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.

Facility Fee

The SPV will receive from the Eligible Lender a facility fee of 100 basis points of the principal amount of the loan participation purchased by the SPV. The Eligible Lender may require the Eligible Borrower to pay this fee.

Loan Origination and Servicing

The Eligible Lender will receive from the Eligible Borrower an origination fee of 100 basis points of the principal amount of the Eligible Loan. The Eligible Lender will receive from the SPV an annual servicing fee of 25 basis points of the principal amount of its participation in the Eligible Loan.

Facility Termination

The SPV will cease purchasing participations in Eligible Loans on September 30, 2020, unless the Federal Reserve and the Treasury Department extend the Facility. The Reserve Bank will continue to fund the SPV after such date until the SPV's underlying assets mature or are sold.

2. The Main Street Expanded Loan Facility

Eligible Lenders

Eligible lenders are U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies.

Eligible Borrowers

Any business with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues created or organized in the United States, or under the laws of the United States, may participate. However, it must have significant operations in—and a majority of its employees based in—the United States.

Eligible Borrowers that participate in the Expanded Facility may not also participate in the Facility or the Primary Market Corporate Credit Facility (another Federal Reserve program).

Eligible Loans

An Eligible Loan is a **term loan** made by an Eligible Lender to an Eligible Borrower that was **originated before April 8, 2020**, provided that **the upsized tranche of the term loan** has the following features:

1. Four year maturity;
2. Amortization of principal and interest deferred for one year;
3. Adjustable rate of SOFR + 250-400 basis points;
4. Minimum loan size of $1 million;
5. Maximum loan size that is the lesser of (i) $150 million, (ii) 30% of the Eligible Borrower's existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added to the Eligible Borrower's existing outstanding and committed but undrawn debt, does not exceed six times the Eligible Borrower's 2019 earnings before EBITDA; and
6. Prepayment permitted without penalty.

Loan Participations

The SPV will purchase from the Eligible Lender a 95% participation in the upsized tranche of the Eligible Loan, provided that it is upsized on or after April 8, 2020, at par value. The SPV and the Eligible Lender will share risk in the upsized tranche on a *pari passu* basis. Any collateral securing an Eligible Loan—whether such collateral was pledged under the original terms of the Eligible Loan or at the time of upsizing—will secure the loan participation on a *pro rata* basis.

Required Attestations From Eligible Borrowers

An Eligible Borrower will be required to make attestations with respect to the upsized tranche of each Eligible Loan in which the SPV acquires an interest. In the attestations, each Eligible Borrower must:

- Commit to refrain from using the proceeds of the upsized tranche of the Eligible Loan to repay other loan balances;
- Commit to refrain from repaying other debt of equal or lower priority, with the exception of mandatory principal payments, unless the Eligible Borrower has first repaid the Eligible Loan in full;
- Attest that it requires the financing due to the exigent circumstances presented by the COVID-19 crisis and that, using the proceeds of the upsized tranche of the Eligible Loan, it will make reasonable efforts to maintain its payroll and retain its employees during the term of the upsized tranche of the Eligible Loan;
- Attest that it will not seek to cancel or reduce any of its outstanding lines of credit with the Eligible Lender or any other lender;
- Attest that it meets the EBITDA leverage condition stated in section 5(iii) of the paragraph above specifying required features of Eligible Loans;
- Attest that it will follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act; and
- Certify that it is eligible to participate in the Expanded Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.

Attestation From Eligible Lenders

Each Eligible Lender will be required to make attestations with respect to the upsized tranche of each Eligible Loan. In the attestations, each Eligible Lender must:

- Attest that the proceeds of the upsized tranche of the Eligible Loan will not be used to repay or refinance pre-existing loans or lines of credit made by the Eligible Lender to the Eligible Borrower, including the pre-existing portion of the Eligible Loan;

- Attest that it will not cancel or reduce any existing lines of credit outstanding to the Eligible Borrower; and
- Certify that it is eligible to participate in the Expanded Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.

Loan Upsizing and Servicing

The Eligible Lender will receive from the Eligible Borrower a fee of 100 basis points of the principal amount of the upsized tranche of the Eligible Loan at the time of upsizing. The Eligible Lender will receive from the SPV an annual servicing fee of 25 basis points of the principal amount of its participation in the upsized tranche of the Eligible Loan.

Facility Termination

The SPV will cease purchasing participations in Eligible Loans on September 30, 2020, unless the Federal Reserve and the Treasury Department extend the Expanded Facility. The Reserve Bank will continue to fund the SPV after such date until the SPV's underlying assets mature or are sold.

Compliance with Section 4003(c)(3)(A)(ii) and Section 4019 of the CARES Act

Under the Facility and the Expanded Facility, the Eligible Borrower must comply with Section 4003(c)(3)(A)(ii) of the CARES Act. This section requires the Eligible Borrower to agree that:

- Until the date 12 months after the date on which the Eligible Loan is no longer outstanding, it will not repurchase an equity security that is listed on a national securities exchange of the Eligible Borrower—or any parent company of the Eligible Borrower—while the Eligible Loan is outstanding, except to the extent required under a contractual obligation that is in effect as of the date of enactment of CARES Act; and
- Until the date 12 months after the date on which the Eligible Loan is no longer outstanding, it will not pay dividends or make other capital distributions with respect to the common stock of the Eligible Borrower; and
- It will comply with the limitations on compensation set forth in Section 4004 of the CARES Act.

Section 4004 of the CARES Act provides that an Eligible Borrower must agree that:

- No officer or employee of the Eligible Borrower whose total compensation exceeded $425,000 in 2019 (other than employee whose compensation is determined through an existing collective bargaining agreement entered into prior to March 1, 2020) will receive from the Eligible Borrower (i) total compensation, which exceeds during any 12 consecutive months of such period the total compensation received such officer or employee from the Eligible Borrower in 2019; or (ii) severance pay or other benefits upon termination of employment with the Eligible Borrower which exceeds twice the maximum total compensation received by the officer or employee from the Eligible Borrower 2019; and
- No officer or employee of the Eligible Borrower whose total compensation exceeded $3,000,000 2019 may receive during any 12 consecutive months of such period total compensation in excess of the sum of:
  - $3,000,000; and
  - 50% of the excess over $3,000,000 of the total compensation received by the officer or employee from the Eligible Borrower 2019.

The term "total compensation" includes salary, bonuses, awards of stock, and other financial benefits provided by an Eligible Borrower to an officer or employee of the Eligible Borrower.

In addition, each Eligible Borrower and Eligible Lender must comply with the conflicts of interest provisions of Section 4019 of the CARES Act, which requires the principal executive officer and principal financial officer of an Eligible Borrower or an Eligible Lender to certify that it is not a Covered Entity.

A "Covered Entity" means an entity in which a Covered Individual directly or indirectly holds a Controlling Interest. For the purpose of determining whether an entity is a Covered Entity, the securities owned, controlled, or held by two or more individuals who are related as described in the second bullet point of the definition of Covered Individual shall be aggregated.

A "Covered Individual" is:

- The President, Vice President, head of an Executive department, or a Member of Congress; and
- The spouse, child, son-in-law, or daughter-in-law, as determined under applicable common law, of an individual described above.

The term "Controlling Interest" means owning, controlling, or holding not less than 20%, by vote or value, of the outstanding amount of any class of equity interest in an entity.

The term "equity interest" means:

- A share in an entity, without regard to whether the share is:
  - transferable; or
  - classified as stock or anything similar.
- A capital or profit interest in a limited liability company or partnership; or
- Warrant or right, other than a right to convert, to purchase, sell, or subscribe to a share or interest described in either of the two preceding bullet points.

3. Paycheck Protection Program Loan Facility

On April 9, 2020, the Federal Reserve Board (the "Board") created the Paycheck Protection Program Loan Facility (the "PPP Facility") to facilitate lending by eligible borrowers to small businesses under the Paycheck Protection Program ("PPP Loans"). Under the PPP Facility, Federal Reserve Banks ("Reserve Banks") will lend to eligible borrowers on a non-recourse basis, taking PPP Loans as collateral.

The Board and the Secretary of the Treasury may make adjustments to the terms and conditions of the PPP facility. Any changes will be announced on the Board's website.

Eligible Borrowers

All depository institutions that originate PPP Loans are eligible to borrow under the PPP Facility. The Board is working to expand eligibility to other lenders that originate PPP Loans in the near future.

Lending Reserve Bank

Eligible borrowers will participate in the PPP Facility through the Reserve Bank in the District where the eligible borrower is located.

Collateral

Only PPP Loans guaranteed by the SBA are eligible to serve as collateral for the PPP Facility.

PPP Loans pledged as collateral to secure extensions of credit under the PPP Facility will be valued at the principal amount of the PPP Loan.

Principal Amount

The principal amount of an extension of credit under the PPP Facility will be equal to the principal amount of the PPP Loan pledged as collateral to secure the extension of credit.

Maturity and Acceleration of Maturity

The maturity date of an extension of credit under the PPP Facility will equal the maturity date of the PPP Loan pledged to secure the extension of credit.

The maturity date of a PPP Loan will be accelerated:

- If the underlying PPP Loan goes into default and the eligible borrower sells the PPP Loan to the SBA to realize on the SBA guarantee; and
- To the extent of any loan forgiveness reimbursement received by the eligible borrower from the SBA.

Rate

Extensions of credit under the PPP Facility will be made by the Reserve Banks at a rate of 35 basis points. The rate on the PPP Loans made by the banks to borrowers is 1%.

Fees

There are no fees associated with the PPP Facility.

Non-Recourse

Extensions of credit under the PPP Facility are made without recourse to the borrower.

Regulatory Capital Treatment

Under section 1102 of the CARES Act, a PPP Loan is assigned a risk weight of zero percent under the risk-based capital rules of the federal banking agencies.

The agencies' capital rules require banking organizations to comply with risk-based and leverage capital requirements, which are expressed as a ratio of regulatory capital to assets and certain other exposures.

Participation in the PPP Facility will affect the balance sheet of a bank because the bank must originate and hold PPP Loans (that is, assets that are eligible collateral pledged to the Reserve Banks) on its balance sheet. As a result, a bank that participates in the PPP Facility could potentially be subject to increased regulatory capital requirements.

On April 9, 2020, the agencies adopted the interim final rule would permit banking organizations to exclude exposures pledged as collateral to the PPP Facility from its total leverage exposure, average total consolidated assets, advanced approaches-total risk-weighted assets, and standardized total risk-weighted assets, as applicable.

Facility Termination Date

No new extensions of credit will be made under the Facility after September 30, 2020, unless the Board and the Department of the Treasury determine to extend the PPP Facility.