Relief for Middle Market Companies: New Details on the Main Street Lending Program

Alert
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On April 9, 2020, the Federal Reserve announced its Main Street Lending Program (MSLP), which in its initial form consisted of two facilities through which the Federal Reserve would purchase participations in loans that met the requirements of the program. As we noted at the time, the MSLP is intended to support businesses that were in good financial health before the COVID-19 crisis by offering loans on favorable terms to certain companies committed to make reasonable efforts to maintain payroll and retain workers, including both borrowers that obtained (or could have obtained) Paycheck Protection Program (PPP) loans and borrowers that did not qualify for PPP loans. Following the release of term sheets for two components of the MSLP, the Main Street New Loan Facility (MSNLF) and the Main Street Expanded Loan Facility (MSELF), the Federal Reserve received well over 2,000 comment letters. In response to feedback, the Federal Reserve released updated terms for the MSLP on April 30, 2020. In addition to modifying some of the previously announced terms, the April 30 update added a third loan facility, the Main Street Priority Loan Facility (MSPLF). This update provides information on the MSLP, giving effect to the April 30 updates, and supplements our prior alert on the MSLP.

OVERVIEW AND STATUS OF THE PROGRAM

The MSLP is not a currently active program and it has not yet been announced when the program will officially launch. The Federal Reserve notes that it is working to create the necessary infrastructure to support the program. Once the program has been officially launched, borrowers should contact eligible lenders to apply for loans. In addition, further updates may be made to the program, so the terms described in this alert should not be
considered final.

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Further guidance regarding the application process for borrowers and the process by which eligible lenders can sell MSLP loan participations to the special purpose vehicle (SPV) set up by the Federal Reserve for the MSLP (which we now know will run through the Federal Reserve Bank of Boston) will be forthcoming. In addition, a form loan participation agreement, borrower and lender certifications, and other form documents will be provided by the Federal Reserve. However, the Federal Reserve will not provide forms of the actual loan documents and instead will rely on eligible lenders to document the loans appropriately, with the caveat that the loan documents must conform to the terms of the MSLP in order to qualify for participation purchases by the SPV.

Participation in the MSLP facilities will not be anonymous. In addition to regular reporting of aggregate characteristics, the Federal Reserve will publish the names of lenders and borrowers, the amounts borrowed, and the interest rates charged, as well as overall costs, revenues and other fees.

Certain aspects and requirements of the MSLP are uniform across the three facilities — MSNLF, MSELF and MSPLF — while certain other aspects and requirements differ slightly among them.

THE ROLE OF THE SPV

- The SPV will purchase majority participations at par in eligible loans originated by eligible lenders through the three facilities in "true sale" transactions. The purchases of the participations will be "completed expeditiously" after the closing of the original MSLP loan.
- The SPV will purchase 95% participations in MSNLF loans (with the originating lender retaining 5%), 95% of the upsized tranche of MSELF loans (with the lender retaining 5%), and 85% of MSPLF loans (with the originating lender retaining 15%). The originating lender and the SPV will share risk on a pari passu basis.
- The portion of the loan participation not purchased by the SPV must be retained by the issuing lender until either the loan has been repaid or the SPV has sold the entirety of its participation.
  - For MSELF loans, the lender must have been one of the issuing lenders for the underlying loan that is being upsized, and the lender must maintain its position in the underlying loan until the underlying loan matures, the upsized MSELF tranche matures, or the SPV sells its entire 95% participation. However, if the underlying loan is a multi-lender facility, the other lenders in the underlying loan may sell out of the loan – only the MSELF lender is required to maintain its position in the underlying loan.
- The SPV will purchase participations until September 30, 2020, unless the MSLP facilities are extended by the Federal Reserve, and the combined size of the SPV's participation in the three facilities will be up to
  $600 billion.

LENDER ELIGIBILITY

Across all three MSLP facilities, an eligible lender may be:

- A U.S. federally insured depository institution
- A U.S. branch or agency of a foreign bank
- A U.S. bank holding company
- A U.S. savings and loan company
- A U.S. intermediate holding company of a foreign banking organization
- A U.S. subsidiary of any of the foregoing

BORROWER ELIGIBILITY

The following MSLP borrower eligibility requirements are consistent across all three MSLP facilities:

- The borrower must be a U.S.-based, for-profit business, regardless of legal organizational form. Joint ventures must have less than 49% participation by foreign business entities. Borrowers must have "significant operations" in the U.S. and a majority of their employees must be located in the U.S.
- At this time, nonprofits are not eligible for the MSLP. This is based in part on the fact that borrower risk under the MSLP is assessed via reference to adjusted EBITDA, which is a measure not commonly applied to nonprofits. The same consideration applies to asset-based borrowers not typically evaluated on the basis of EBITDA. However, there are indications in the term sheets and the official Frequently Asked Questions by the Federal Reserve (FAQs) that the Federal Reserve may consider changes to the program to make it available to non-profits and asset-based borrowers in the future.
- The borrower cannot be within the category of ineligible businesses set forth in subsections (b) – (j) and (m) – (s) of 13 CFR 120.110, which is the Small Business Administration (SBA) list of ineligible businesses that may be familiar to some due to the PPP.
- The borrower must have either 15,000 or fewer employees or have had 2019 annual revenues of $5 billion or less. The employee and revenue tests must each be applied with respect to the borrower and its affiliates, using the same SBA affiliation rules that are applicable to the PPP.
  - In a further similarity to the PPP, the number of employees must be determined by reference to the number of individual employees (regardless of part-time or full-time status), as opposed to being based on a full-time equivalent metric.
  - For calculating 2019 annual revenue, a borrower can rely on its 2019 GAAP revenue as reported in the borrower's audited financial statements or its annual receipts as reported to the IRS, with "receipts" having the meaning specified by the SBA in 13 CFR 121.104(a). A borrower that wishes to use its GAAP

revenue, but has not yet received its 2019 audited financial statements, is permitted to rely on GAAP revenue as reported on its most recently available audited financial statements.

- A borrower can participate in only one MSLP facility but can receive multiple loans under the facility, provided that a borrower cannot receive MSLP loans in an aggregate amount greater than $25 million under the MSNLF or MSPLF or $200 million under the MSELF. A borrower cannot participate in an MSLP facility and also the Primary Market Corporate Credit Facility.
- The FAQs released by the Federal Reserve indicate that a borrower "must have been in sound financial condition prior to the onset of the COVID-19 pandemic" in order to be eligible for an MSLP loan. While this exact terminology does not appear in any of the MSLP facility term sheets, each facility does specifically require that, if the borrower had loans outstanding with the lender as of December 31, 2019, then such loans must have had an internal risk rating equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system.

TERMS OF MSLP LOANS AND FEES

- PPP loans were "automatic" in a sense because limited lender underwriting was required, all eligible borrowers received loans to the extent money was available, and the SBA guaranteed 100% of all eligible loans. In contrast, under the MSLP lenders will be conducting their own risk assessments of borrowers, through their own underwriting procedures, and must make their own assessments of the financial condition of the borrower before agreeing to make an MSLP loan. This makes intuitive sense, since the MSLP requires the lender to retain a slice of the risk relating to the loan for its duration (or until the Federal Reserve exits its participation in full).
- MSLP loans must be originated after April 24, 2020 (with the caveat that under the MSELF the underlying loan may be a pre-existing revolving credit facility), and may be secured or unsecured depending on the determination of the appropriate level of security by the lender. MSLP loans must be term loans.
- For upsized tranches of existing loans under the MSELF, the underlying loan must have a remaining maturity of at least 18 months, taking into account any adjustments made to the term up to the origination of the upsized MSELF tranche. Even where the underling MSELF loan is a revolving facility, the upsized MSELF tranche must be a term loan. The lender may require additional security to extend an upsized tranche under the MSELF.
- MSLP loans will have a four-year maturity, with principal and interest payments deferred for one year.
- The interest rate on MSLP loans will be LIBOR (one or three months) plus 300 basis points (this is a departure from the original term sheets which specified SOFR and generated concerns from many lenders).

- A portion of the principal of MSLP loans is amortized each year, with a balloon payment due at maturity. For MSNLF loans, one-third of the principal is amortized at the end of each of the second and third years, with the remaining one-third due at maturity. For the MSPLF and MSELF loans, 15% of the principal is amortized at the end of the second and third years, with a 70% balloon payment due at maturity.
- MSLP loans may be prepaid without penalty.
- The minimum amount of MSNLF and MSPLF loans is $500,000, while the minimum amount of an MSELF loan is $10 million.
- Under the MSNLF, the maximum loan amount will be the lesser of $25 million or an amount that does not exceed four times the borrower's 2019 adjusted EBITDA when added to outstanding indebtedness and undrawn available indebtedness.
- The methodology used by the lender to compute adjusted EBITDA must be the same methodology the lender has previously used to compute adjusted EBITDA for the borrower on a prior loan, if applicable, or the same methodology the lender uses when extending credit to similarly situated borrowers.
- Under the MSPLF, the maximum loan amount will be the lesser of $25 million or an amount that does not exceed six times the borrower's 2019 adjusted EBITDA when added to outstanding indebtedness and undrawn available indebtedness.
  - The methodology used by the lender to compute adjusted EBITDA must be the same methodology the lender has previously used to compute adjusted EBITDA for the borrower on a prior loan, if applicable, or the same methodology the lender uses when extending credit to similarly situated borrowers.
- Under the MSELF, the maximum loan amount will be the lesser of (i) $200 million, (ii) an amount that does not exceed six times the borrower's 2019 adjusted EBITDA when added to outstanding indebtedness and undrawn available indebtedness, or (iii) 35% of the sum of the borrower's existing outstanding indebtedness and its committed but undrawn available debt that is pari passu in priority and equivalent in secured status (i.e., secured or unsecured) with the MSELF upsized tranche.
  - The methodology used by the lender to compute adjusted EBITDA must be the same methodology used when extending credit on the underlying loan that is being upsized.
  - Outstanding and committed but undrawn available debt includes all amounts borrowed under any facility from any lender, as well as unused commitments under any loan facility, but excluding (i) undrawn commitments on backup lines for commercial paper issuance, (ii) undrawn commitments used to finance receivables, including seasonal financing of inventory, (iii) undrawn commitments that cannot be drawn without additional collateral, and (iv) undrawn commitments that are no longer available due to changes in circumstances. The calculation should be made at the time of the loan application.

- The seniority and priority of the MSLP loans differs somewhat depending on the particular facility.
  - An MSNLF loan cannot be contractually subordinated in terms of priority to any of the borrower's other loans or debt instruments, either at the time of origination or at any time while the MSNLF is outstanding. However, this does not prevent an MSNLF loan from being unsecured when other indebtedness of the borrower is secured, nor does it prevent the borrower from taking on new secured or unsecured indebtedness after receiving an MSNLF loan (regardless of whether the MSNLF loan is secured or unsecured). Rather, this requirement only means that the MSNLF loan cannot be contractually junior in priority in a bankruptcy proceeding.
  - MSPLF and MSELF loans must be senior to, or pari passu with, the borrower's other loans and debt instruments (excluding mortgage debt) in terms of priority and security status, both at the time of origination and at all times while the loan is outstanding.
  - Whatever collateral secures the underlying loan that is upsized through an MSELF loan (whether existing at the time of the origination of the MSELF upsized tranche or subsequently added) must also secure the upsized MSELF tranche on a pro rata basis.
- The SPV will earn a transaction fee, payable by the MSLP lender, of 100 basis points on the principal amount of the loan at the time of origination for the MSNLF and the MSPLF and 75 basis points for the MSELF. The lender is allowed to pass the transaction fee on to the borrower.
- An MSLP borrower must pay the lender an origination fee of up to 100 basis points of the principal amount of the loan at the time of origination.
- The SPV will pay the lender 25 basis points of the principal amount of its participation in the loan per annum as a servicing fee. Further guidance and detail regarding credit administration and loan servicing will be forthcoming.

LENDER CERTIFICATIONS AND COVENANTS

The following certifications and covenants required of eligible lenders participating in MSLP loan programs are consistent across the three facilities:

- The lender must commit to refrain from requesting that the borrower repay principal on indebtedness or make interest payments on indebtedness (other than mandatory payments that are due) until the MSLP loan is repaid in full – in other words the lender cannot ask the borrower to use MSLP funds to pay down debt ahead of schedule.
- The lender must commit to refrain from cancelling or reducing any of its existing committed lines of credit to the borrower, unless an event of default occurs. However, this provision does not prohibit a lender from (i) reducing or terminating uncommitted lines of credit, (ii) allowing existing lines of credit to expire 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.

- The lender must certify that it has made the adjusted EBITDA calculations in accordance with the requirements of the applicable facility.
- The lender must certify that it is eligible to participate in the MSLP, including in light of the conflict of interest provisions set forth in Section 4019(b) of the CARES Act.

BORROWER CERTIFICATIONS AND COVENANTS

Several of the required borrower certifications and covenants mirror those of lenders and are uniform across the three MSLP facilities (subject to one exception noted below). Lenders are required to collect, and are entitled to rely on, the certifications (and subsequent borrower self-reports) and have no duty to investigate the borrower's certifications and self-reports. However, if a lender becomes aware of a material misstatement by a borrower, or of another breach of a covenant during the term of an MSLP loan, the lender should notify the Federal Reserve Bank of Boston.

- The borrower must commit to refrain from repaying principal on indebtedness or making interest payments on indebtedness (other than mandatory payments that are due) until the MSLP loan is repaid in full. The one exception is that a borrower may use the proceeds of an MSPLF loan to refinance existing debt owed to other lenders.
  - The prohibition on repaying other debts does not prohibit (i) repaying a line of credit or credit card in the normal course of business usage for the line of credit, (ii) taking on additional normal course debt obligations on standard terms, including inventory and equipment financing, as long as the new financing is only secured by newly acquired property and is of equal or lower priority than MSLP loans, and (iii) refinancing maturing debt.
- The borrower must commit to refrain from seeking to reduce or cancel any of its committed lines of credit with any lender.
- The borrower must certify that it has a reasonable basis to believe that, as of the date of origination and after giving effect to the MSLP loan, it will be able to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that 90-day period.
- The borrower must commit that it will follow the compensation, stock repurchase, and capital distribution restrictions under Section 4003(c)(3)(A)(ii) of the CARES Act. Specifically, this means that for the duration of the MSLP loan and for one year thereafter – a five-year period in all unless the MSLP loan is prepaid:
  - Neither the borrower nor any parent company (or, in specified industries, any "affiliate") can make purchases of publicly traded securities.

- The borrower cannot pay any dividends or make any distributions with respect to "common stock." We previously wondered how this provision (which appears drafted with public companies in mind) would be interpreted. However, the Federal Reserve has provided an exception to the prohibition on distributions to allow distributions by S-corps and other pass through entities only to the extent reasonably necessary to cover tax obligations in respect of the entity's earnings. Judging from this exception, the Federal Reserve is interpreting the prohibition on dividends on common stock to apply to all forms of distributions, regardless of entity type or class of equity.
- The borrower cannot pay any employee whose total compensation exceeded $425,000 in 2019 more total compensation in any 12-month period than the employee earned in 2019, nor can the borrower provide severance pay or other termination benefits to any such employee in an amount exceeding two times the employee's 2019 total compensation.
- The borrower cannot pay any employee whose total compensation exceeded $3 million in 2019 compensation in any 12-month period in excess of the sum of (i) $3 million, and (ii) 50% of the employee's 2019 total compensation in excess of $3 million.

- The borrower must certify that it is eligible to participate in the MSLP, including under the conflict of interest provisions of the CARES Act.
- The borrower "should make commercially reasonable efforts to maintain its payroll and retain its employees" during the term of an MSLP loan. It is curious that this covenant uses "should" as opposed to "must" when describing the borrower's obligation.
  - The FAQs indicate that this requires the borrower to undertake 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 needs for labor."
  - The fact of having furloughed or laid off workers does not make a business ineligible for an MSLP loan.

The firm stands ready to assist borrowers, banks and other lenders in their analysis and consideration of the Main Street Lending Program. Please contact us if we can assist you in navigating this complex program. The firm's Coronavirus Task Force is monitoring and prepared to quickly and efficiently respond to questions and ongoing legal issues unique to the coronavirus situation including, but not limited to, employment and labor matters, contract enforcement and force majeure issues, and insurance coverages. Please visit our website for information on the Task Force members and all previously issued COVID-19 alerts.

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