ALERT MEMORANDUM

Federal Reserve Announces Expansion and Clarifications of Main Street Lending Facilities

May 1, 2020

Yesterday, the Federal Reserve announced a new Main Street Priority Loan Facility ("**MSPLF**") and modifications to the Main Street New Loan Facility ("**MSNLF**") and Main Street Expanded Loan Facility ("**MSELF**" and, collectively with the MSPLF and MSNLF, the "**Main Street Lending Program**"). The Federal Reserve also released the first set of FAQs for these facilities. These developments follow a public comment process in which the Federal Reserve received more than 2,200 comment letters.

The new MSPLF will provide new loan borrowers with an opportunity to leverage their balance sheets and income to a greater degree than the MSNLF, but will require the originating lender to retain a higher portion of the loan (15%) in comparison to the other Main Street facilities. The modifications to the MSNLF and MSELF expand eligibility to larger businesses, but they also impose an affiliation test that will limit eligibility. This alert memorandum summarizes the key takeaways from yesterday's announcement, focusing on the major changes to the Program for both borrowers and lenders.

The term sheets are available here (MSELF), here (MSNLF) and here (MSPLF). Blacklines showing revisions to the term sheets are available here (MSELF) and here (MSNLF), and a blackline comparing the MSNLF terms to the MSPLF terms is available here. The FAQs for all facilities are available here.

Headlines

- The modifications expand the scope of and eligibility for the Main Street Lending Program, but they also provide greater clarity on borrowers that may be ineligible. On the one hand, the Federal Reserve has expanded borrower eligibility by increasing both the size and 2019 annual revenue caps, from 10,000 to 15,000 employees and from $2.5 billion to $5 billion . . .

- But, on the other hand, the Federal Reserve has restricted eligibility through an affiliation test linked to the Small Business Association's ("**SBA**") rules that require a borrower to count all of its subsidiaries, parent companies and affiliates in determining if it is below the size and revenue thresholds.

- No additional guidance was provided regarding some eligibility criteria, such as what it means for a borrower to have "significant operations in" the United States.

- The FAQs contain guidance on determining maximum loan amounts, perhaps most importantly regarding permissible adjustments to EBITDA and how to calculate "existing outstanding and undrawn available debt".

- Eligible lenders were clarified to include U.S. branches or agencies and U.S. intermediate holding companies ("**IHCs**") of foreign banks, as well as U.S. subsidiaries of IHCs and bank / savings & loan holding companies.

- Program documentation is still to come, and there have been no definitive public statements yet about when the Main Street Lending Program will become operational.

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Lender and Borrower Eligibility Criteria

- Lender and borrower eligibility criteria are the same for all facilities.

- Eligibility criteria for lenders has been expanded to include U.S. branches and agencies of foreign banks, U.S. intermediate holding companies of foreign banks and any U.S. subsidiary of bank, intermediate or savings & loan holding companies. The Federal Reserve has also clarified that savings associations and credit unions are eligible lenders.

- The revenue ($5 billion in 2019 annual revenues) and employee (15,000) size caps for all facilities have been increased, as described above.

  - The Federal Reserve has clarified in the FAQs that revenues may be either revenues under 2019 GAAP audited financial statements or annual receipts for FY 2019 as reported to the Internal Revenue Service.

  - If 2019 statements are not available, then a borrower should use information from its most recent audited financial statements or annual receipts.

- Despite increasing the revenue and employee limits, the new affiliation rule will require borrowers to aggregate employees and revenues across its parent, affiliates and subsidiaries.

  - In contrast to the affiliation rule for borrowers under the SBA's Paycheck Protection Program ("**PPP**"), which is also authorized by the CARES Act, the affiliation rule for the Main Street Lending Program is not waived for hotels, restaurants and other accommodation and food services businesses, nor for franchised businesses.

  - The affiliation rule is likely to result in, among other things, (i) some portfolio companies backed by private equity funds or venture capital funds and (ii) U.S. subsidiaries of larger U.S. and foreign companies being ineligible for loans because each controlled company must generally aggregate its employees with other controlled companies (and a majority of employees must be based in the United States).

- Also, despite increasing these limits, several types of businesses are now ineligible for participation—even if they meet the other eligibility criteria.

  - Any borrower that is a "joint venture" must have no more than 49% participation by foreign business entities. The Federal Reserve has not provided guidance on what would classify an entity as a joint venture.

  - Borrowers that are ineligible to obtain SBA loans are also ineligible for the Main Street Lending Program, with the exceptions that the SBA has provided in its rules implementing the PPP (e.g., nonprofits, educational and religious institutions, and businesses with legal gaming revenues). Ineligible businesses include businesses located in a foreign country, pyramid sale distribution plans, passive businesses owned by developers and landlords that do not actively use or occupy the assets involved in the loan, private clubs and businesses that limit membership, and a handful of others.

  - The Federal Reserve stated in the FAQs that it is evaluating the feasibility of expanding eligibility to include nonprofits and asset-based borrowers. The FAQs acknowledge that EBITDA is the "key underwriting metric" for the lending facilities, but the credit risk of these two types of borrowers is generally not evaluated on the basis of EBITDA.

Loan Eligibility Criteria

- The loan maturity (4 years) and interest rate (1- or 3-month LIBOR + 300 bps) are the same for all facilities. While the loan maturity remains unchanged, the reference rate has switched from SOFR to LIBOR. This was an area of significant comment, notwithstanding the campaign by governments and central banks to transition away from LIBOR.

- While principal and interest remains deferred for one year under all facilities, the Federal Reserve has revised the principal amortization schedule after the first year. For the MSNLF, 33% is due in each of the remaining three years. For the MSPLF and the MSELF, 15% is due at the end of each of years two and three, with a balloon payment of 70% due at maturity at the end of year four.

- The MSELF has added revolving credit facilities as a type of eligible loan that may be upsized (the prior terms only permitted term loans to be upsized). However, the upsized tranche must be a term loan. Further, the revised terms specify that the underlying loan must have a remaining maturity of at least 18 months. A loan that does not initially meet this requirement may be adjusted at the time of upsizing.

- All facilities now explicitly permit either secured or unsecured loans. The prior terms for the MSNLF only permitted unsecured loans, while the prior terms for the MSELF were silent on this point. Any collateral securing the underlying, existing loan in the MSELF (at the time of upsizing, or at any subsequent date) must also secure the facility's loan participation on a pro rata basis.

- All facilities have new terms laying out an expectation that a lender will assess each borrower's financial condition and that if a lender had a relationship as of December 31, 2019 with a borrower that receives a loan under a facility, such previous loans must have had an internal risk rating equivalent to a "pass" in the federal supervisory rating system on that date.

- The revised terms contain some additional clarity and exceptions regarding where a loan will fit in a borrower's capital stack.

  - For the MSELF and MSPLF, the loan must be (and remain) senior to or pari passu with, in terms of priority and security, the borrower's other loans or debt instruments (other than mortgage debt).

  - For the MSNLF, the loan must not be contractually subordinated in terms of priority to any of the borrower's other loans or debt instruments (with no apparent exceptions, even for mortgage debt), and must remain that way during the term of the loan.

- The minimum and maximum loan amounts have been adjusted.

  - For the MSELF, the minimum has increased from $1 million to $10 million and the maximum has increased to the lesser of (i) $200 million (up from $150 million), (ii) 35% of the borrower's existing outstanding and undrawn available bank debt that is pari passu in priority with the eligible loan and equivalent in secured status (up from 30%, and the pari passu/security provisions are new) and (iii) does not exceed 6x adjusted EBITDA when added to existing outstanding and undrawn available debt (unchanged).

  - For the MSNLF, the minimum has decreased to $500,000 (down from $1 million) and the maximum remains unchanged at the lesser of $25 million or an amount that does not exceed 4x adjusted EBITDA when added to existing outstanding and undrawn available debt.

- For all facilities, the Federal Reserve has clarified that EBITDA can be adjusted.
  - For the MSNLF and MSPLF, the methodology must be the methodology that a lender previously used for adjusting EBITDA when extending credit to that borrower or to "similarly situated" borrowers on or before April 24, 2020. The Federal Reserve has not provided specific guidance on how to determine a "similarly situated" borrower.
  - For the MSELF, the methodology must be the methodology that a lender previously used for adjusting EBITDA when originating or amending the underlying loan.
- For the MSELF, the Federal Reserve has clarified that "existing outstanding and undrawn available debt" includes all amounts borrowed under any loan facility, including unsecured or secured loans from any bank, non-bank financial institution, or private lender, as well as any publicly issued bonds or private placement facilities. It also includes all unused commitments under any loan facility, excluding any undrawn commitment that (i) serves as a backup line for commercial paper issuance, (ii) is used to finance receivables (including seasonal financing of inventory), (iii) cannot be drawn without additional collateral, or (iv) is no longer available due to change in circumstance.

Loan Participations

- In recognition of the increased credit risk of loans made under the MSPLF (due to the 6x permitted debt-to-EBITDA ratio compared to a 4x ratio for the MSNLF), a lender must retain 15% of an eligible loan (in contrast to 5% for the MSNLF and MSELF, which remains unchanged).
- For new loans under the MSNLF or MSPLF, a lender must hold its portion of a loan until the earlier of the loan's maturity or when the facility sells all of its participation. For upsized tranches of loans under the MSELF, a lender must both (i) hold its portion of the upsized tranche until the earlier of the loan's maturity or when the facility sells all of its participation, and (ii) retain its interest in the "underlying Eligible Loan" until the earlier of the underlying loan's maturity, the upsized tranche's maturity, or when the facility sells all of its participation.
- The Federal Reserve has specified that a lender's sale of the loan participation to the facility will be a "true sale", so a lender will not need to account for the participated portion of the loan on its balance sheet (and therefore also will not need to account for the participated portion of the loan for risk-based and leverage capital purposes).

Certifications and Covenants

- The Federal Reserve has changed the borrower and lender "attestations" into "certifications and covenants". This shift reflects the general approach in the revised terms of relying more heavily on lenders as gatekeepers (e.g., by also requiring lenders to assess the financial condition and eligibility of each borrower in connection with making a loan). The key changes include:
  - A lender must now commit that it will not request that a borrower repay debt extended by the lender to the borrower, or pay interest on those outstanding obligations until the loan is repaid, other than mandatory payments that are due or in the case of default and acceleration. This change now covers only actions within the lender's control, in contrast to the prior terms that required the lender to attest that the borrower would not use the loan proceeds to repay these obligations.
  - A lender must now certify that that the methodology used for calculating a borrower's adjusted EBITDA is consistent with the guidance described above.

  - There is no longer a certification that a borrower requires financing due to exigent circumstances presented by COVID-19.

  - A borrower must also commit not to pay principal or interest on other existing debt, other than mandatory principal and interest payments when due while a facility loan or upsized tranche is outstanding.

    - However, an MSPLF borrower may refinance through the MSPLF loan any other debt owed to a lender that is not the eligible lender in the MSPLF loan.

    - The FAQs specify that this covenant would not prohibit a borrower from repaying a line of credit (including a credit card) in the ordinary course nor from taking on and paying additional debt obligations required in the ordinary course, including inventory and equipment financing (so long as these debt obligations are secured by newly acquired property and are of equal or lower priority than the loan or upsized tranche sold to the facility).

  - In recognition of a restriction on the Federal Reserve lending to insolvent borrowers, a borrower must now certify that it has a reasonable basis to believe that it has the ability to meet its financial obligations for at least the next 90 days after receiving the loan and does not expect to file for bankruptcy during that time period. The Federal Reserve did not provide further guidance on whether some missed payments (e.g., rent or utilities) may prevent a borrower from making this certification.

- As CARES Act facilities, each requires that a borrower abide by the CARES Act dividend, stock buyback and compensation restrictions. However, the Federal Reserve has provided some limited relief from the restrictions on paying dividends for borrowers that are S corporations or other tax pass-through entities. These borrowers may pay dividends to the extent reasonably required to cover owners' tax obligations.

- While no longer a certification requirement, the revised term sheet states that borrowers should make commercially reasonable efforts to maintain payroll and retain employees during the time the loan is outstanding.

- Consistent with its statement on April 23 (here), the Federal Reserve will publicly disclose for all facilities, at least every 30 days, the names and details of participants; amounts borrowed and interest rate charged; and overall costs revenues and fees.

Fees

- Fees to the MSNLF and MSPLF facilities will be 100 bps, and to the MSELF facility will be 75 bps, payable by the lender (or the lender may pass the fee through to the borrower) at origination. During the life of the loan, each facility will pay 25 bps per year to the lender for servicing the loan.

- The revised terms provide discretion for a lender to charge the borrower an additional origination fee of up to 100 bps (MSNLF and MSPLF) or up to 75 bps (MSELF).

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