Updated Guide to the Main Street Lending Program

Skadden

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Introduction

The Main Street lending program is a key component of the federal government's response to the economic impact of the COVID-19 pandemic. Implemented and primarily funded by the Federal Reserve, the program is expected to facilitate hundreds of billions of dollars of low-interest loans to a wide range of businesses.

The Federal Reserve first mentioned its intent to create a Main Street program to facilitate loans to small- and medium-sized businesses in a broader press release on March 23, 2020. An outline of the Main Street program's contemplated structure and terms did not emerge until the Federal Reserve released initial term sheets on April 9, 2020. The Federal Reserve then issued revised term sheets, as well as guidance in the form of answers to frequently asked questions, on April 30, 2020. Those materials are available here.

The revised term sheets and accompanying guidance made a number of changes and answered many questions raised by the initial term sheets. One overall effect of the changes was generally to expand the universe of businesses that will be eligible to participate in the Main Street program. Nevertheless, many interpretive questions remain unanswered. We expect that the Federal Reserve will continue to refine the details of the program through FAQs and similar guidance before, and even while, the program is operational.

Sources of Government Funding for the Main Street Program

The Main Street program derives its legal authority and government funding from two places: (i) an equity investment by the U.S. Department of the Treasury (Treasury) authorized under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and (ii) emergency debt funding provided by the Federal Reserve under Section 13(3) of the Federal Reserve Act.

The CARES Act became law on March 27, 2020. The economic stimulus package in the CARES Act included federal funding for business stimulus in three broad categories: (i) funding to support small businesses through programs administered by the Small Business Administration (SBA), including the Paycheck Protection Program (PPP); (ii) support in the form of grants and loans from Treasury to passenger air carriers and related businesses, cargo air carriers and businesses critical to maintaining national security; and (iii) authority for Treasury to invest more than $450 billion in lending

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programs to be established by the Federal Reserve.[1] Using funds authorized under this third category, Treasury will make an initial $75 billion equity investment in the Main Street program.

The total dollars available under the Main Street program will be much greater than the amount invested by Treasury. The Main Street program also will draw on the Federal Reserve's practically unlimited financial capacity as the U.S. central bank. The Federal Reserve has long-standing authority under Section 13(3) of the Federal Reserve Act to implement and fund lending programs in "unusual and exigent circumstances."[2] Using this emergency lending authority, the Federal Reserve will provide significant debt funding to the Main Street program.[3]

Taking into account both Treasury's equity investment of $75 billion and the Federal Reserve's emergency debt funding, the Federal Reserve set the initial aggregate size of the Main Street program at $600 billion. The Federal Reserve indicated that it will continue to assess the situation and may adjust the size of the program in the future.

Basic Structure of the Main Street Program

The Main Street program consists of three facilities: Main Street New Loan Facility, Main Street Priority Loan Facility and Main Street Expanded Loan Facility. The table below highlights key features of the three facilities. However, all three facilities have the same basic structure.

Under the Main Street program, an eligible borrower may apply to an eligible lender for term credit that has a four-year maturity with payments deferred during the first year, has an interest rate of LIBOR plus 3%, and is prepayable without penalty. As part of the loan application, the applicant will provide to the lender a number of certifications to establish that the applicant meets the criteria of an eligible borrower under the Main Street program. Those eligibility criteria are summarized in the section below on eligible borrowers.

[1] The Main Street program implemented by the Federal Reserve should not be confused with the "Assistance to Mid-Sized Businesses" provisions in the CARES Act. Those other provisions in the CARES Act contemplate a different program by Treasury, which would have conditioned borrower participation on a series of certifications related to employment levels, restoration of compensations and benefits, outsourcing and offshoring, collective bargaining agreements and union organizing. The Main Street program is authorized under different provisions and does not require these additional certifications. To date, Treasury has not released any information about, or suggested that it is working on, a program pursuant to the Assistance for Mid-Sized Businesses provisions of the CARES Act.

[2] *See* 12 U.S.C. § 343(3); 12 C.F.R. § 201.4(d).

[3] Section 13(3) limits the Federal Reserve's ability to take credit risk in connection with emergency lending programs. Treasury's equity investment in the Main Street program will absorb any initial losses suffered by the program, which will mitigate credit risk to the Federal Reserve and help satisfy the statutory conditions for the Federal Reserve's use of emergency lending authority under Section 13(3).

The Main Street program is not like the SBA's PPP, in which small business applicants that meet the basic eligibility requirements are processed by banks without much additional case-by-case review by the lender. In the Main Street program, simply meeting the Federal Reserve's criteria as an eligible borrower will not entitle an applicant to be approved or to receive the maximum allowable loan amount. The ultimate decision whether to extend credit to the applicant will rest with the lender. The Federal Reserve has made clear that lenders should "apply [their] own underwriting standards in evaluating the financial condition and creditworthiness of the borrower" and that lenders may require additional information and documentation from applicants.[4]

If a lender approves the applicant for a Main Street loan, then the lender will originate and fund the loan. The lender will then be able to sell a participation in the loan (85% or 95% depending on the applicable Main Street facility) at par to a special purpose vehicle established by the Federal Reserve. The lender will retain the remaining interest in the loan and will service the loan.

By selling the participation in the Main Street loan to the Federal Reserve-backed special purpose vehicle, the lender will significantly mitigate its credit risk and capital cost of extending credit to the borrower. In this manner, the Federal Reserve intends that lenders will be more willing to extend credit at favorable terms to eligible borrowers and thereby support the economy during the pandemic.

Eligible Lenders

Eligible lenders in the Main Street program are U.S. federally insured depository institutions (*e.g.*, FDIC-insured banks and thrifts and NCUA-insured credit unions), U.S. branches and agencies of foreign banks, and many U.S. nonbank affiliates of the foregoing. There is no requirement that eligible lenders participate or offer Main Street loans to their customers.

Eligible Borrowers

This section summarizes the key criteria to be an eligible borrower under the Main Street program.

U.S. Presence

An eligible borrower must be a for-profit[5] business that:

- was established prior to March 13, 2020;
- was created or organized in the United States or under the laws of the United States;

[4] *See* Federal Reserve, Main Street Lending Program Frequently Asked Questions, as of April 30, 2020 (FAQ) at I.2.

[5] The Federal Reserve indicated that it is "evaluating a separate approach" to meet the needs of nonprofit organizations.

- has "significant operations in" the United States; *and*
- has a "majority of its employees based in" the United States.

Nothing in the CARES Act or the Federal Reserve guidance to date suggests that a party who otherwise meets these criteria would be disqualified from participating solely because it has a non-U.S. parent company.

Size Test. An eligible borrower must meet at least one of the following two size tests.

Employee Count. The borrower and all of its affiliates together had 15,000 or fewer employees based on the average total number of employees for each pay period over the 12 months prior to origination of the Main Street loan. Businesses should count as employees all full-time, part-time, seasonal or otherwise employed persons, excluding volunteers and independent contractors.

Revenue. The borrower and all of its affiliates together had 2019 annual revenues of $5 billion or less. The Federal Reserve guidance provides alternative methodologies to determine revenues for this purpose, allowing reliance on either 2019 audited financial statements in accordance with GAAP or annual receipts for 2019 as reported to the Internal Revenue Service (IRS). The Federal Reserve guidance to date does not indicate a methodology to be used if neither of these sources is applicable (*e.g.*, unaudited financial statements, non-GAAP accounting or receipts not required to be reported to the IRS).

Both of these size tests require aggregation of the borrowing entity with its affiliates.[6] In determining what entities are affiliates of the borrower for purposes of these size tests, the Federal Reserve guidance incorporates by reference the affiliation rules of the SBA.[7] The SBA affiliation rules generally treat entities as affiliates based on a concepts of control and common control. Such control can exist under the SBA affiliation rules under various circumstances based on ownership (including at levels below 50% of voting stock), common management, governance rights (*e.g.*, veto rights over major decisions of board of directors), economic dependence or other relationships. We note that these size tests are the only areas of the Main Street term sheets or guidance that, on their face, require (or permit) the borrowing entity to aggregate with its affiliates.

Loans With Lender Must Have Been Considered 'Pass'

Banks generally maintain internal risk monitoring programs that assign risk ratings to loans and other credits consistent with supervisory guidance from their regulators. A loan is typically considered "pass" when the bank has not risk-rated the loan as having potential weaknesses deserving bank management's close attention (*i.e.*, special mention) or worse (*i.e.*, substandard, doubtful or loss). If a Main Street applicant had other loans outstanding with the lender as of December 31, 2019, then those other loans generally must have been considered "pass" within the lender's internal risk rating system as of December 31, 2019.[8]

Must Not Be Insolvent

The Federal Reserve is not permitted to use its emergency lending authority under Section 13(3) to lend to parties who are "insolvent." To address this statutory limitation, the Federal Reserve will require each borrower in the Main Street program to certify that: "[I]t has a reasonable basis to believe that, as of the date of origination of the [Main Street loan] and after giving effect to such loan, it has the ability to meet its financial obligations for at least 90 days and does not expect to file for bankruptcy during that time period."

Must Not Be on List of Ineligible Businesses

An eligible borrower must not be deemed an "ineligible business" under certain SBA regulations cited in the Federal Reserve term sheets.[9] Some examples of "ineligible businesses" are financial businesses primarily engaged in the business of lending; passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except for certain eligible passive companies defined under the SBA regulations); life insurance companies; and hedge funds and private equity firms (although portfolio companies of hedge funds and private equity firms may be eligible).

Unable To Secure Adequate Credit Accommodation

Section 13(3) requires the Federal Reserve, when using its emergency lending authority, to obtain evidence that participants are "unable to secure adequate credit accommodations from other banking institutions." Federal Reserve regulations provide flexibility in how the Federal Reserve can meet this requirement, including by relying on evidence of economic or market conditions generally or on a simple certification from the participant. It is unclear from the term sheets and guidance to date whether the Federal Reserve will require Main Street participants to provide any specific representation or certification with respect to the inadequacy of adequate credit accommodations.

In its guidance for another pandemic-related Section 13(3) program — the Primary Market Corporate Credit Facility

[6] This is a change from the original Main Street term sheets, which did not require aggregation.

[7] *See* 13 C.F.R. § 121.301(f).

[8] The term sheet for the Expanded Loan Facility appears to impose this "pass" requirement only with respect to the Original Credit (defined in the table below).

[9] *See* 13 C.F.R. § 120.110(b)-(j) and (m)-(s), as modified by regulations implementing the PPP.

(PMCCF) — the Federal Reserve indicated that participants will be required to make a certification that adequate credit accommodations are not available. But the Federal Reserve clarified that, in making the certification, participants "may consider economic or market conditions in the market intended to be addressed by the [Federal Reserve lending program] as compared to normal conditions, including the availability and price of credit. Lack of adequate credit does not mean that no credit is available. Credit may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market."[10]

Limitation on Participation in Other Stimulus Programs

An eligible borrower must not have received specific support under Title IV of the CARES Act, which generally refers to those stimulus programs providing grants and direct loans to specific industries (*e.g.*, air carriers and related businesses, air cargo and national security). The Federal Reserve made clear that participation in the SBA PPP does *not* prohibit a borrower from also participating in the Main Street program.

An eligible borrower may participate in only one of the Main Street facilities and may not also participate in the Federal Reserve's PMCCF. The PMCCF is a Federal Reserve program that purchases newly issued bonds, or makes syndicated loans to, investment-grade borrowers.

Prohibition on Certain Capital Distributions

A Main Street borrower must comply with the following prohibitions while the loan is outstanding *and* for an additional 12 months.

No Buybacks of Publicly Traded Equity. A Main Street borrower may not repurchase equity securities of itself or its parent that were listed on a national exchange while the loan was outstanding, except as otherwise required pursuant to a contract in effect on March 27, 2020.

No Dividends or Capital Distributions on Common Stock. A Main Street borrower may not pay dividends or make other capital distributions on common stock. In its revised term sheets and guidance, the Federal Reserve clarified that this prohibition 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.

[10] Federal Reserve Bank of New York, FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility (as of May 4, 2020).

Restrictions on Compensation

A Main Street borrower must comply with the following compensation restrictions while the loan is outstanding and for one additional year.

No Increases for Employees Above $425,000. An officer or employee of the borrower whose total compensation exceeded $425,000 in calendar year 2019 may not receive (i) total compensation from the borrower during any 12-consecutive-month period exceeding the total compensation that individual received in calendar year 2019 or (ii) severance pay or other benefits upon termination of employment exceeding twice the total compensation that individual received in calendar year 2019. This limitation does not apply to employees whose compensation is determined through an existing collective bargaining agreement entered into prior to March 1, 2020.

Cutback for Employees Above $3 Million. An officer or employee of the borrower whose total compensation exceeded $3 million in calendar year 2019 may not receive total compensation from the borrower during any 12-consecutive-month period in excess of the sum of $3 million plus 50% of the total compensation over $3 million the individual received in calendar year 2019.

For purposes of these restrictions on compensation, the CARES Act defines "total compensation" to include "salary, bonuses, awards of stock, and other financial benefits provided by [the borrower] to an officer or employee of the [borrower]."[11]

Efforts to Maintain Payroll and Retain Employees

The Federal Reserve term sheets state that a Main Street borrower "should make commercially reasonable efforts to maintain its payroll and retain its employees during the time the [Main Street loan] is outstanding."[12] The guidance appears to refine this "commercially reasonable efforts" standard and explains that a Main Street borrower should "undertake good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor."[13] It is unclear what form this requirement may take in the definitive documentation of Main Street loans.

[11] CARES Act § 4004(b).

[12] This is a change from the original Main Street term sheets, which would instead have required a borrower to attest "it will make reasonable efforts to maintain its payroll and retain its employees during the term of the [Main Street loan]."

[13] *See* FAQ G.8. The Federal Reserve guidance also makes clear that businesses that have already laid off or furloughed workers as a result of the COVID-19 crisis may still be eligible for the Main Street program.

Public Disclosure of Participation

Parties considering the Main Street program should expect that their participation will become public. The Federal Reserve has indicated that it will publicly disclose information regarding participation in the Main Street program, including the names of lenders and borrowers, amounts borrowed, interest rates charged, and overall costs, revenues and fees. In addition, the CARES Act grants Congress significant oversight authority, and establishes various oversight and investigatory bodies, with respect to the economic stimulus programs that receive funding thereunder, which includes the Main Street program.

Key Features of the Three Main Street Facilities

The table below highlights key features of the three Main Street facilities.

	New Loan Facility	Priority Loan Facility	Expanded Loan Facility
Form of credit	Newly originated term loan	Newly originated term loan	To be eligible for the Expanded Loan Facility, the borrower must have an existing term loan or revolving credit facility (the Original Credit) with the same lender that will provide the credit under the Main Street program. The Main Street credit will take the form of an "upsized tranche" to the Original Credit The Original Credit must: - have been originated on or before April 24, 2020; - have a remaining maturity of at least 18 months (taking into account any adjustments to maturity after April 24, 2020, including at time of Main Street upsizing); and - have been considered "pass" in the lender's internal risk rating system as of December 31, 2019 If the Original Credit was part of a multi-lender facility, Federal Reserve guidance appears to contemplate that any eligible lender participating in the Original Credit may provide the upsized tranche under the Main Street program if the lender owns an interest in the Original Credit at the time of upsizing
Minimum size	$500,000	$500,000	$10 million

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	New Loan Facility	Priority Loan Facility	Expanded Loan Facility
Maximum size	The lesser of: i. $25 million; and ii. an amount that, when added to the borrower's existing outstanding debt and undrawn available debt, does not exceed *four* times the borrower's 2019 adjusted EBITDA 2019 adjusted EBITDA is to be determined based on the methodology used by the lender for the borrower or for similarly situated borrowers on or before April 24, 2020	The lesser of: i. $25 million; and ii. an amount that, when added to the borrower's existing outstanding debt and undrawn available debt, does not exceed *six* times the borrower's 2019 adjusted EBITDA 2019 adjusted EBITDA is to be determined based on the methodology used by the lender for the borrower or for similarly situated borrowers on or before April 24, 2020	The lesser of: i. $200 million; ii. an amount that, when added to the borrower's existing outstanding debt and undrawn available debt, does not exceed *six* times the borrower's 2019 adjusted EBITDA; and iii. 35% of the borrower's existing outstanding debt and undrawn available debt that is *pari passu* in priority with the Original Credit (including the upsized loan tranche) and equivalent in secured status (*i.e.*, secured or unsecured) 2019 adjusted EBITDA is to be determined using the same methodology used by the lender when it originated or amended the Original Credit on or before April 24, 2020
Interest rate	LIBOR (1 or 3 month) + 3%	LIBOR (1 or 3 month) + 3%	LIBOR (1 or 3 month) + 3%
Term	4 years	4 years	4 years
Amortization of principal	Principal and interest payments deferred for first year, with unpaid interest capitalized Year 1: 0% Year 2: 33.33% Year 3: 33.33% Year 4: 33.33%	Principal and interest payments deferred for first year, with unpaid interest capitalized Year 1: 0% Year 2: 15% Year 3: 15% Year 4: 70%	Principal and interest payments deferred for first year, with unpaid interest capitalized Year 1: 0% Year 2: 15% Year 3: 15% Year 4: 70%

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	New Loan Facility	Priority Loan Facility	Expanded Loan Facility
Security and priority	Main Street loans under this facility need *not* be secured — even if the borrower has, or obtains in the future, other loans that are secured Main Street loans under this facility must not be "contractually subordinated in terms of priority to any of the [borrower's] other loans or debt instruments." We view this condition as prohibiting the borrower from agreeing to subordinate payments of the Main Street loan to payments on the borrower's other outstanding loans	Main Street loans under this facility 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." Although this Federal Reserve language is not entirely clear, we view it as requiring the Main Street loan to be equal in lien and payment priority with the borrower's other loans, excluding mortgage debt	If the Original Credit is secured, then any collateral securing the Original Credit at the time of upsizing or thereafter must secure the Main Street upsized tranche on a pro rata basis The Main Street upsized tranche 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." Although this Federal Reserve language is not entirely clear, we view it as requiring the Main Street upsized tranche to be equal in lien and payment priority with the borrower's other loans, excluding mortgage debt
Use of Main Street proceeds to repay non-maturing debt	Not permitted	At the time of origination of the Main Street loan under this facility, the borrower may refinance existing debt owed by the borrower to a lender that is not the lender making the Main Street loan	Not permitted
Fees	One-time transaction fee of 100 bps paid by the borrower or lender to the Federal Reserve One-time origination fee up to 100 bps paid by the borrower to the lender Annual servicing fee of 25 bps of the principal amount of the Federal Reserve's participation paid by the Federal Reserve to the lender	One-time transaction fee of 100 bps paid by the borrower or lender to the Federal Reserve One-time origination fee up to 100 bps paid by the borrower to the lender Annual servicing fee of 25 bps of the principal amount of the Federal Reserve's participation paid by the Federal Reserve to the lender	One-time transaction fee of 75 bps of the principal amount of the upsized tranche paid by the borrower or lender to the Federal Reserve One-time origination fee up to 75 bps of the amount of the upsized tranche paid by the borrower to the lender Annual servicing fee of 25 bps of the principal amount of the Federal Reserve's participation paid by the Federal Reserve to the lender
Lender's risk retention	Lender must retain 5% of the Main Street loan until earlier of maturity or the Federal Reserve sells all of its participation	Lender must retain 15% of the Main Street loan until earlier of maturity or the Federal Reserve sells all of its participation	Lender must retain 5% of the upsized tranche until earlier of maturity of the upsized tranche or the Federal Reserve sells all of its participation Lender must retain its interest in the Original Credit until earliest of maturity of the Original Credit, maturity of the upsized tranche, or the Federal Reserve sells all of its participation