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FEDERAL RESERVE ANNOUNCES DETAILS OF NEW MAIN STREET LENDING PROGRAM

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On April 9, 2020, the Board of Governors of the Federal Reserve System (Federal Reserve) **announced** the details of the Main Street Lending Program (Program), authorized under Section 13(3) of the Federal Reserve Act and constituting part of the Coronavirus Economic Stabilization Act of 2020 found in Title IV of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). We anticipate regulatory or interpretive guidance from the Federal Reserve and U.S. Treasury Department (Treasury Department) over the coming weeks, but this alert provides an overview of the Program as it is currently constituted.

Background

The Program will make up to $600 billion of loans available to small and medium-sized businesses employing up to 10,000 employees or with 2019 revenues of less than $2.5 billion. Loans under the Program, like the Small Business Administration’s (SBA) Paycheck Protection Program (which is described in further detail in our prior Client Alerts published on **March 31, 2020** and **April 4, 2020**), will be made by private lending institutions rather than directly from the Federal Reserve or the Treasury Department. Lending institutions eligible to participate are limited to U.S.-insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies. Eligible lenders will make loans under the Program through two new facilities: the Main Street New Loan Facility for new loans (New Loans) and the Main Street Expanded Loan Facility for expansions of existing loans (Expanded Loans). Perhaps most notably, the Program does not include a forgiveness element comparable to that included in the Paycheck Protection Program, or a grant component similar to that part of the SBA’s Economic Injury Disaster Loan program for coronavirus (COVID-19) loans.

Mechanically, the Federal Reserve will lend funds to a special purpose vehicle (SPV), which will in turn purchase 95% participations in the Program loans made by lending institutions. The lenders would retain 5% of each Program loan.

Eligible Borrowers

The Program is available to businesses of the sizes stated above, organized in the U.S. and with material operations and a majority of employees based in the U.S. Businesses that participate in the Program may receive loans under the Paycheck Protection Program, but they may not receive loans under the Federal Reserve’s previously announced Primary Market Corporate Credit Facility. Similarly, businesses may only receive either New Loans or Expanded Loans (but not both).

Loan Terms

New Loans

New Loans under the Program, made on or after April 8, 2020, will be unsecured and will carry a four-year maturity, with amortization of principal and interest deferred for one year. Interest will be variable, based on the Secured Overnight Financing Rate (SOFR) published each business day by the Federal Reserve Bank of New York + 250-400 basis points. For reference, prior to the COVID-19 crisis, SOFR had been roughly 150 basis points during 2020. As of the date of this publication, the SOFR rate is one basis point. The minimum New Loan size will be $1 million, with a maximum set at the lesser of (i) $25 million or (ii) the amount that would result in the applicant having outstanding debt, including the undrawn portion of any committed lines, of not more than four times EBITDA (based on 2019 results). The borrower will pay its lender a fee of 100 basis points on the principal of the New Loan, and the Federal Reserve's SPV will pay the lender an additional 25 basis points as a servicing fee. However, the lender will be required to pay to the SPV a facility fee of 100 basis points on the portion purchased as a participation.

A full version of the Federal Reserve's term sheet for New Loans can be found **here**.

Expanded Loans

The Program also provides for borrowers and lenders to agree to upsize existing term loans made prior to April 8, 2020. The upsized tranches of these loans will have the same terms as described above with respect to New Loans, except that the maximum amount of the loan will be the lesser of (i) $150 million, (ii) 30% of the borrower's existing outstanding debt, including the undrawn portion of any committed lines, or (iii) the amount that would result in the applicant having outstanding debt, including the undrawn portion of any committed lines, of not more than six times EBITDA. In addition, if the existing loan is secured by collateral prior to being upsized, that same collateral will secure the Expanded Loan. The borrower will pay its lender a fee of 100 basis points on the principal of the Expanded Loan, and the SPV will pay the lender an additional 25 basis points for as a servicing fee. The Program does not require that lenders pay the SPV a facility fee for Expanded Loans.

A full version of the Federal Reserve's term sheet for Expanded Loans can be found **here**.

Certifications and Requirements

Each borrower under the Program will be required to make certain attestations, including that it will:

- refrain from using the proceeds of the loans under the Program to repay other loan balances;
- refrain from repaying other debt of equal or lower priority, with the exception of mandatory principal payments, unless the loans under the Program have first been repaid in full;
- not seek to cancel or reduce any of their outstanding lines of credit;
- make reasonable efforts to maintain its payroll and retain their employees during the term of the loan under the Program, and certify that they require financing due to the exigent circumstances presented by the COVID-19 pandemic;
- meet the EBITDA leverage condition described above; and

- agree to follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under the CARES Act. We expect additional guidance from the Federal Reserve on these points, but generally they apply to employee compensation above $425,000 and prohibit dividends and other capital distributions and stock repurchases by publicly traded companies until 12 months after the loans under the Program have been repaid.

Each lender under the Program is separately required to attest that:

- loan proceeds will not be used to repay or refinance pre-existing loans or lines of credit made by the lender to the borrower, including with respect to Expanded Loans, the pre-existing portion of the loan; and
- the lender will not cancel or reduce any existing lines of credit available to borrower.

Finally, lenders and borrowers are both required to attest that they eligible to participate in the Program, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.

Unresolved Questions and Points to Consider

There are a number of unresolved questions and open points based on the guidance provided to date. For example, when determining the leverage limits, it is unclear whether EBITDA means solely earnings before interest, taxes, depreciation, and amortization or if borrowers and lenders will have discretion to negotiate other “addbacks” of the types customarily found in loan agreements. In addition, it is unclear whether the employee headcount and revenue limitations on eligibility will be required to factor in affiliated entities in the same or a similar manner as under the Paycheck Protection Program, although at this time it appears that the affiliation rules will not apply to loans under the Program. It is also unclear whether restrictions on the payment of dividends and other capital distributions would apply to businesses with pass-through taxation that make regular tax distributions to their owners. In addition, the Federal Reserve (through the SPV) will purchase 95% participations in the loans once funded, but it remains to be seen whether and how the requirement that lenders retain 5% of the Program loans will deter lenders from participating in the Program. In addition, a potential borrower would need to consider any existing debt as it relates to Program loans. Specifically, most loan agreements prohibit or restrict additional debt, so borrowers would need to amend such agreements to permit the Program loans (assuming incumbent lenders would be willing to do so). Even if unsecured, it appears that loans under the Program would be at least pari passu with any other debt, which means that, in connection with the requirement that no other debt of equal or lower priority be repaid (other than mandatory principal payments) until the Program loans are repaid in full, incumbent lenders would be asked to agree to de facto payment subordination. It is unclear whether existing lenders would be willing to subordinate their rights. Finally, it is uncertain at this time whether nonprofit businesses will be eligible to participate in the Program, and we expect the Federal Reserve and the Treasury Department will face mounting pressure from hospitals, universities and other large nonprofits in the coming days to clarify that nonprofit businesses are eligible for Program loans.

As the economic and regulatory climate resulting from COVID-19 evolves, Smith Anderson will continue to provide updates as the Federal Reserve, the Treasury Department and other governmental entities issue additional guidance. If you have any questions related to this alert, please do not hesitate to contact your regular Smith Anderson lawyer or any other member of our firm. Additionally, please visit and bookmark our firm’s **Coronavirus (COVID-19) Business Resource Center**, which is updated continuously with useful materials and resources related to COVID-19. This tool has been made available to ensure our clients and the broader business community stay informed on key issues that may impact their operations and to navigate the related

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business and legal issues during these challenging times.

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