Simpson Thacher

Memorandum

Federal Reserve Establishes Main Street Business Lending Program

April 10, 2020

On April 9, 2020, the Federal Reserve announced seven new or expanded programs providing up to $2.3 trillion in loans to support the economy, including through increased credit flows to small- and medium-sized businesses. A significant portion of the $2.3 trillion[1] is allocated towards the establishment of the Main Street Business Lending Program, which will make up to $600 billion in new financing in the form of four-year term loans available to businesses with up to (i) 10,000 employees or (ii) $2.5 billion in 2019 annual revenues that were in good financial standing before the crisis. The Treasury, using funds appropriated to the Exchange Stabilization Fund[2], will make a $75 billion equity investment to backstop the Main Street Program.

The Main Street Program includes two facilities: (i) the Main Street New Loan Facility ("New Main Street Facility"), under which the Federal Reserve will purchase, through a special purpose vehicle ("SPV") 95% participations in loans made by U.S. banking organizations to borrowers under new loan facilities,[3] and (ii) the Main Street Expanded Loan Facility ("Expanded Main Street Facility"), underwhich the Federal Reserve will purchase 95% participations in upsized tranches of certain existing term loans made by U.S. banking organizations.[4]

Importantly, borrowers that obtain loans must satisfy a leverage ratio not to exceed four times debt to the borrower's 2019 earnings before interest, taxes, depreciation and amortization ("2019 EBITDA") in the case of the New Main Street Facility, and not to exceed six times debt to 2019 EBITDA in the case of the Expanded Main Street Facility. Borrowers will also be subject to restrictions on compensation, stock buybacks and dividends. Furthermore, borrowers will have to determine whether the loans, both as to their amount and the related restrictions, are permitted, or otherwise affect rights and obligations, under any existing debt agreements, equity agreements and/or other contractual obligations, and whether separate amendments or consents may be required under any such agreements in order for the borrower to participate. Finally, borrowers will be required to make

[1] The remaining $1.7 trillion goes towards a $350 billion expansion of the Small Business Administration's Paycheck Protection Program ("PPP") through term financing backed by PPP loans to small businesses, expanding the size and scope of the PMCCF and the Secondary Market Corporate Credit Facility ("SMCCF") and the Term Asset-Backed Securities Loan Facility ("TALF") by $750 billion and $100 billion respectively, and the establishment of a Municipal Liquidity Facility ("MLF") that will offer up to $500 billion in lending to states and municipalities.

[2] Established under Section 4027 of the CARES Act.

[3] "Term Sheet: Main Street New Loan Facility," effective April 9, 2020, *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a7.pdf.

[4] "Term Sheet: Main Street Expanded Loan Facility," effective April 9, 2020, *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a4.pdf.

certain commitments, including using reasonable efforts to maintain its payroll and its employees during the term of the loan and not using the loan to repay other indebtedness.[5] Borrowers can only participate in one of the two facilities, and cannot also participate in the Primary Market Corporate Credit Facility ("PMCCF").[6]

The Federal Reserve released the following high-level description of the terms of the New and Expanded Main Street Facilities, and indicated that these terms are subject to adjustment; changes will be posted to their website.

Facilities' Key Terms

- **Eligible Lenders**: U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies.
- **Eligible Borrowers**: Businesses with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues and must be organized in the United States with significant operations in and a majority of its employees in the United States.
- **Eligible Loans**: The New and Expanded Main Street Facilities contemplate term loans with four year maturities with amortization of principal and interest deferred for one year, an adjustable interest rate of SOFR (which, under the Term Asset-Backed Securities Loan Facility, is defined as the 30-day average secured overnight financing rate) +250-400 basis points (presumably set at the discretion of the lending institution), a minimum loan size of $1 million and prepayment permitted without penalty.
    - *New Main Street Facility-specific features*: unsecured term loans originated on or after April 8, 2020; maximum loan size that is the lesser of (i) $25 million or (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed four times the borrower's 2019 EBITDA.
    - *Expanded Main Street Facility-specific features*: borrowers must have an existing term loan originated before April 8, 2020 (existing revolving facilities do not qualify); maximum loan size of the upsized tranche that is the lesser of (i) $150 million, (ii) 30% of the borrower's existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed six times the borrower's 2019 EBITDA.
- **Loan Participations**: The Federal Reserve will, through its SPV, purchase a 95% participation in each loan at par value, and the lender will retain 5% of the loan; the Federal Reserve and the lender will share risk on a pari passu basis.
    - New Main Street Facilities may not be collateralized.

[5] A borrower under the Main Street Program would not be subject to the more detailed restrictions set forth in section 4003(c)(3)(D) relating to the Assistance for Mid-Sized Businesses program, including retaining at least 90% of the borrower's workforce at full compensation and benefits through September 30, 2020.

[6] The PMCCF was established on March 23, 2020 to support credit to investment grade companies and provides bridge financing for up to four years; the facility was expanded on April 9, 2020.

- Under the Expanded Main Street Facility, any collateral securing a loan, whether pledged under the original terms of the loan or at the time of the upsizing, will secure the loan participation on a pro rata basis.
  - Thus, by participating in the program, the lender would potentially reduce its collateral coverage for its current loan exposure since the same collateral pool would also secure the new upsized loan.[7]

- **Required Commitments**: The following commitments will be required with respect to each loan:
  - Proceeds of the loan may not be used to repay or refinance pre-existing loans or lines of credit made by the lender to the borrower.
  - Proceeds of the loan may not be used by the borrower to (i) repay other loan balances to the lender or (ii) repay other debt of equal or lower priority, with the exception of mandatory principal payments, until the loan is repaid in full.
  - Outstanding lines of credit may not be cancelled or reduced by either the lender or the borrower.
  - The borrower must attest that it requires financing due to the coronavirus disease 2019 ("COVID-19") pandemic and that, using the loan's proceeds, it will make reasonable efforts to maintain its payroll and retain its employees during the term of the loan.
  - The borrower must attest that it meets the 2019 EBITDA leverage conditions specified above.
  - The borrower must commit to follow the compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under the CARES Act.[8]
  - Both the lender and the borrower must certify that the borrower is eligible to participate in the facility, including in light of the CARES Act conflict of interest rules.[9]

- **Facility Fee** *(New Main Street Facility only)*: The lender will pay the Federal Reserve a facility fee of 100 basis points of the principal amount of the loan participation purchased by the Federal Reserve; the lender may require the borrower to pay this fee.

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[7] The term sheet is ambiguous on whether a lender can require a borrower to post additional collateral to an existing facility.

[8] CARES Act, H.R. 748, 116th Con. (2020) § 4003(c)(3)(A)(ii). Those provisions require a borrower to agree that until 12 months after the loan is repaid, it will not (1) repurchase an equity security that is listed on an national securities exchange of the borrower or any parent company of the borrower, except as contractually obligated or (2) pay dividends or make other capital distributions with respect to the common stock of the borrower. Additionally, a borrower must abide by the compensation guidelines in section 4004 of the CARES Act, which require that, until 12 months after the loan is repaid, (1) any officer or employee of the borrower whose 2019 total compensation exceeded $425,000 cannot receive total compensation greater than their 2019 total compensation, (2) any officer or employee of the borrower whose 2019 total compensation exceeded $3 million cannot receive total compensation greater than the sum of (i) $3 million and (ii) 50% of the excess of their 2019 total compensation over $3 million and (3) any officer or employee of the borrower whose 2019 total compensation exceeded $425,000 cannot receive more than twice their 2019 total compensation as severance pay.

[9] CARES Act, H.R. 748, 116th Con. (2020) § 4019(b) states that no "covered entity" may take part in the CARES Act programs (which include this Main Street Program). A "covered entity" is an entity in which the President, the Vice President, the head of an Executive department, or a Member of Congress, or a spouse, child, son-in-law, or daughter-in-law of such person, directly or indirectly holds a 20% or larger voting or economic interest.

- **Loan Origination and Servicing**: The borrower will pay the lender an origination fee of 100 basis points of the principal amount of the loan. The Federal Reserve will pay the lender an annual servicing fee of 25 basis points of the principal amount of its loan participation.
- **Facility Termination**: The facilities will remain open to purchase participations until September 30, 2020, unless further extended by the Federal Reserve and the Treasury.

Several open questions remain, notably what the definitive documentation will consist of, what the Federal Reserve will consider "debt," how it will define 2019 EBITDA in calculating its leverage test, and how employees will be calculated for purposes of participation in the plan. In addition, it remains unclear whether the SPV purchasing the participations will exercise directly any voting or enforcements rights with respect to the loans. However these issues are ultimately determined, the degree of the SPV's ongoing involvement with the loan—in addition to the leverage tests, the restrictions on executive compensation, dividends, and stock buybacks (which restrictions continue in effect for 12 months after the loan is repaid) and the extent to which incurring these loans will require modifications of existing debt and equity arrangements (and the feasibility of making such modifications)—will likely represent significant issues to many companies seeking to access these new funds.

In his statement announcing the Main Street Program, Federal Reserve Chairman Powell did not mention any plans to implement the Assistance for Mid-Sized Business program ("Mid-Sized Business Program"), which was another program contemplated in the CARES Act designed to provide financing to banks and other lenders to make direct loans to eligible businesses and nonprofit organizations with between 500 and 10,000 employees. Under the Mid-Sized Business program, a borrower would have been subject to a number of additional restrictions not included in the Main Street Program, such as labor and workforce retention commitments (including using loan proceeds to retain at least 90% of its workforce, offering full compensation and benefits until September 30, 2020 and remaining neutral in any union-organizing activity for the term of the loan), and domestic operations commitments (including commitments not to outsource jobs or move jobs offshore for the term of the loan and two years after repayment of the loan). However, the CARES Act did not affirmatively require the Federal Reserve or the Treasury to implement the Mid-Sized Business Program. Following yesterday's announcement of seven new or expanded lending facilities, it is not clear if the Federal Reserve ever intends to implement the Mid-Sized Business Program.

Comments (limited to 1,500 characters) regarding the announced $2.3 trillion loan programs can be submitted to the Federal Reserve by April 16, 2020 via the Federal Reserve's feedback form.

We offer a dedicated team of advisors to help businesses weigh available options and seek assistance under one or more of the liquidity and support programs established under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Whether in the form of direct funding from Treasury, loans or other credit support from a Federal Reserve lending facility or participation in Small Business Administration loan programs, our team has the expertise to help navigate the complex political and legal challenges associated with obtaining government financial assistance and the experience to help access the programs if a decision is made to do so.

Led by Lee Meyerson, who guided the Firm's financial crisis team that advised Treasury in developing, structuring and documenting its $250 billion TARP program for purchasing equity in U.S. financial institutions and related programs, and Keith Noreika, who recently served with Treasury Secretary Mnuchin as acting Comptroller of the Currency, a role in which he also acted as a director of the FDIC and member of the Financial Stability Oversight Council, the cross-disciplinary team also includes financing and governance lawyers, as well as former Treasury and Federal Reserve counsel.

See our Accessing Emergency Government Support Programs webpage for further information.

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