MAIN STREET LENDING PROGRAM EXPANDS ACCESS TO CAPITAL FOR MID-SIZED TO LARGE COMPANIES

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The Federal Reserve announced on April 9, 2020 the Main Street Lending Program for firms that are too large to receive Payroll Protection Program (PPP) loans, but too small to access low-cost public debt markets.

The program has been in the works since Congress passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) in late March. The details must be finalized in the next few weeks. However, the Federal Reserve has issued initial rules and expect to quickly refine the program and formally deploy capital.

Legal basis. The Board of Governors of the Federal Reserve System receives authority from both the CARES Act as well as legacy statutes under the Dodd-Frank legislation following the 2008 financial crisis. Many of the qualifications and conditions for the Main Street Lending Program financing will come from the Federal Reserve Act, as amended by the legislation from the prior financial crisis.

New programs. The Federal Reserve announced two parallel loan programs - Main Street New Loan Program and the Main Street Expanded Loan Program. The Main Street New Loan Program will provide new loans that are seeded with Federal funds, fully-funded by banks, and largely assumed by the Federal government. The Main Street Expanded Loan Program will provide "supersize me" credit expansion to borrowers that already had outstanding bank loans before April 8, 2020. The Expanded Loan Program will provide similar seeding and funding, but targeted only at increasing the borrowings under existing business loans.

How it works. The money will initially come from the borrowing power of the U.S. Treasury and the printing press of the Federal Reserve banks. Then, the funds will be provided to banks, which will in turn lend the money to firms. The government will purchase a 95% interest in the loans at par value from the lenders

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on a *pari passu* basis. The private bank lenders keep 5% of the loans and 5% of the risk that comes with it. Thus, banks can lend money when they do not have the money in the bank vault, since they can count on the Federal government to remit 95% of the money after-the-fact. For the Supersize-me Expanded Loan Program, the Federal Reserve will buy the additional funds lent on top of an existing loan (but not the prior underlying loan).

How much and who pays. The CARES Act authorized $454 billion of funds for direct loans to companies, indirect loans through banks, and market back-stops through open-market purchases of public debt. One portion of the allocation is the creation of a special purpose entity to hold $75 billion. These funds will be placed in commercial banks and other regulated financial institutions. These banks will in turn lend $5 to $10 dollars for every dollar received from the special purpose entity. As a result, this program will generate up to $600 billion of additional lending. This $75 million of seed money will be allocated to each of the New Loan Program and the Expanded Loan Program.

Eligible lenders. Eligible lenders are insured depository institutions, bank holding companies, and savings banks. Conspicuously absent: non-bank lenders that have become nearly ubiquitous in middle market and private equity lending since the financial crisis. The focus on regulated lenders is a refrain from prior crises: The government can pull many regulatory strings over insured and highly-regulated institutions, versus uninsured and unregulated lenders that receive no insurance from the government, and far fewer restrictions on their activities. Banks may make loans under both the New Loan Program and the Expanded Loan Program.

How Fast. In the Payroll Protection Program, the government is trying to get money to companies as fast as water on a burning building. However, the Main Street programs will be more deliberate. Loans will not be forgiven; documentation will be more burdensome; oversight by banks will be more intense. As a result, rules will not be written and applied as quickly. While there is no precise timeline for these loans, the capital may be deployed within several weeks or several months.

Deadlines for application. Funds are available until September 30, 2020.

Eligible Borrowers – both programs. Firms that meet the following criteria:

- Up to 10,000 employees or up to $2.5 billion in 2019 annual revenues;
- Created or organized in the United States or under the laws of the United States;
- Significant operations, and a majority of its employees based, in the United States;
- Cannot be insolvent or in bankruptcy; and
- Borrowers should have been in “good financial standing” before the COVID-19 crisis.

Use of Funds. Borrowers must commit to the following regarding the use of funds:

- No proceeds to repay or refinance pre-existing loans or lines of credit made by the lender;
- “Refrain” from using proceeds to repay other loan balances;
- “Refrain” from repaying other debt of equal or lower priority, with the exception of mandatory principal payments. This requirement terminates after the borrower has first repaid the loan in full;

- Not seek to cancel or reduce any of its outstanding lines of credit with the eligible lender or any other lender; and
- Make reasonable efforts to maintain its payroll and retain its employees during the term of the loan.

Required lender covenants. May not cancel or reduce any existing lines of credit outstanding to the borrower.

Basic Loan Terms – New Loan Program. The general terms of the loans under the New Loan Program are as follows:

- Maturity: four years
- Deferral: Principal and interest for one year
- Interest: Adjustable rate of Secured Overnight Financing Rate (SOFR) (about .1%) plus 5% – 4.0% (that is, 2.6% to 4.1% per year)
- Amount per loan - minimum: $1 million
- Amount per loan – maximum: 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 earnings before interest, taxes, depreciation or amortization (in most cases, pre-tax cash flow).
- Fees: Lender may pass through the 1% lender fee by the government to borrowers
- Security: None
- Revolver: None (only term loan)
- Forgiveness: None

Fees – New Loan Program.

- Facility Fee: Lender pays the government a facility fee of one percent of the principal amount of the loan participation purchased by the government; the lender may pass this fee on to the borrower
- Loan Origination and Servicing Fee: Borrower pays lender an origination fee of one percent of the principal amount of the loan
- Participation/Servicing fee: The Government pays lender .25 percent of the principal amount of the government's participation in the loan per year
- Prepayment fee/penalty: None

Basic Terms – "Supersize Me" Expanded Loan Program.

- Maturity: Four years
- Deferral: Principal and interest for one year
- Interest: Adjustable rate of Secured Overnight Financing Rate (SOFR) (about .1% now, though was as high as 1.5% earlier this year) plus 2.5% – 4.0% (that is, 2.6% to 4.1% per year)
- Amount per loan - minimum: $1 million

- Amount per loan – maximum: 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 earnings before interest, taxes, depreciation, and amortization
- Prepayment penalty: None
- Security: Collateral, if any, that was pledged under the original terms of the loan or at the time of super-sizing, will continue to secure the loan participation
- Forgiveness: None
- Prior loan condition: The existing loan must have been outstanding before April 8, 2020, and the expanded facility provided on or after April 8, 2020

Fees – Expanded Loan Program.

- "Upsizing" Fees: 1% fee imposed by the government on lenders on "expanded" loan amounts
- Servicing fee to lender: 0.25% of the participated portion of the loans

Coordination with other government loans.

- May borrow under the Paycheck Protection Program
- Participation in either, but not both, of the New Loan Program or the Expanded Loan Program
- May not participate in the Federal Reserve's Primary Market Corporate Credit Facility (the public debt re-purchase program)

Basic loan covenants.

- Reasonable efforts to maintain its payroll and retain employees;
- EBITDA leverage conditions;
- No repayment of debt of equal or lower priority (other than required principal payments) before paying off the Main Street loan; and
- Borrowers must not terminate or shrink any outstanding lines of credit, regardless of the original lender.

Special compensation and financing covenants.

- Compensation, stock repurchase and capital distribution restrictions similar to the TARP and other bailout loans under the Dodd-Frank era legislation
- Until one year following repayment, no stock buybacks of equity securities listed on a national securities exchange of borrower or parent (exceptions for contractual obligations entered in to prior to March 27, 2020); and no dividend payments or capital distributions on common stock of the Borrower

Compensation restrictions.

During the term of the loan and for one year thereafter:

- *Pay freeze*. Officers and employees who made over $425,000 in 2019 cannot receive a raise (unless pursuant to selected collective bargaining agreements prior to March 1, 2020)
- *Smaller golden parachute*. Officers and employees whose pay is more than $425,000 cannot receive severance pay above two times the total 2019 compensation
- *Cap on super-salaries*. No officer or employee who made more than $3 million in 2019 may receive annual pay greater than the sum of (a) $3 million, and (ii) one half of the amount of compensation in 2019 that exceeded $3 million

The Federal Reserve is accepting comments regarding these loan programs through April 16, 2020. Shortly thereafter, the Federal Reserve will likely clarify the rules of the programs and initiate the formal process of making funds available to banks and borrowers.