

Main Street Overhaul Before Launch: 8 Key Changes Broaden Size and Risk Parameters; Clarify Program Requirements

The \$600 billion Main Street Lending Program (MSLP) announced on April 9 represents 26% of the Federal Reserve's \$2.3 trillion new and enhanced funding programs. The MSLP targets companies that are too large to use the Paycheck Protection Program (PPP) but too small or not qualified to issue investment grade rated debt through the Primary Market Corporate Credit Facility (PMCCF) or the Secondary Market Corporate Credit Facility (SMCCF). PPP loans are 100% guaranteed by the SBA and include a forgiveness feature for borrowers that satisfy the PPP requirements. MSLP loans will be administered by the Federal Reserve (FRB-Boston) rather than the SBA and are not forgivable.

Before launching the program, the Federal Reserve solicited comments on details including lender eligibility, borrower eligibility, differences between programs, accounting treatment, regulatory capital treatment, and program administration among others. The Federal Reserve received over 2,200 comment letters from lenders, borrowers and other interested parties on the scope of the program along with terms and conditions. These letters suggested a variety of changes to broaden access to funds to a wider variety of borrowers, clarify underwriting and eligibility criteria, and simplify usage of the program.

Key changes include:

- *Higher Risk Borrowers Allowed:* The creation of a third Main Street program referred to as the Main Street Priority Loan Facility (MSPLF) to accommodate borrowers with higher leverage/risk profile but increased retained risk of 15% by Eligible Lenders (defined below) compared to 5% retained risk for Eligible Lenders under the Main Street New Loan Facility (MSNLF);
- *Foreign Banks and Non-banks as Eligible Lenders:* The U.S. branches or agencies of foreign banks and the U.S. intermediate holding companies of foreign banks will be Eligible Lenders and, while non-banks are not currently Eligible Lenders, the Federal Reserve is considering options to expand the list of Eligible Lenders;
- *EBITDA Simplified and Alternative Underwriting Metrics Considered:* Borrowers will be permitted to use the definition of EBITDA in their existing loan agreements rather than the fixed definition initially provided and the Federal Reserve and Treasury will be evaluating the feasibility of allowing asset-based borrowers and non-profit organizations to borrow using alternative underwriting metrics;
- *Smaller Loan Size Permitted:* Reduction in the minimum loan size for the MSPLF and MSNLF from \$1,000,000 to \$500,000;
- *Larger Borrowers Eligible:* Increase in size of eligible borrowers for the MSELF from 10,000 to 15,000 employees or from \$2.5 billion to \$5.0 billion in 2019 total revenue;
- *Larger Loan Size Permitted:* Increase in maximum loan size for the MSELF from \$150 million to \$200 million subject to limitations of other existing debt and leverage restrictions of 6x pro forma EBITDA;
- *Dividend Flexibility:* Greater flexibility to pay dividends and other capital distributions for a tax pass-through entity to the extent reasonably required to cover owners' tax obligations; and
- *Interest Rate Basis, Repayment Terms, and Accounting Treatment Simplified:* The shift in interest rate basis for loans from SOFR to the more commonly used LIBOR, simplification of required principal amortization, and confirmation of the "true sale" treatment for all Main Street loans sold by the Eligible Lender to the Main Street SPV.

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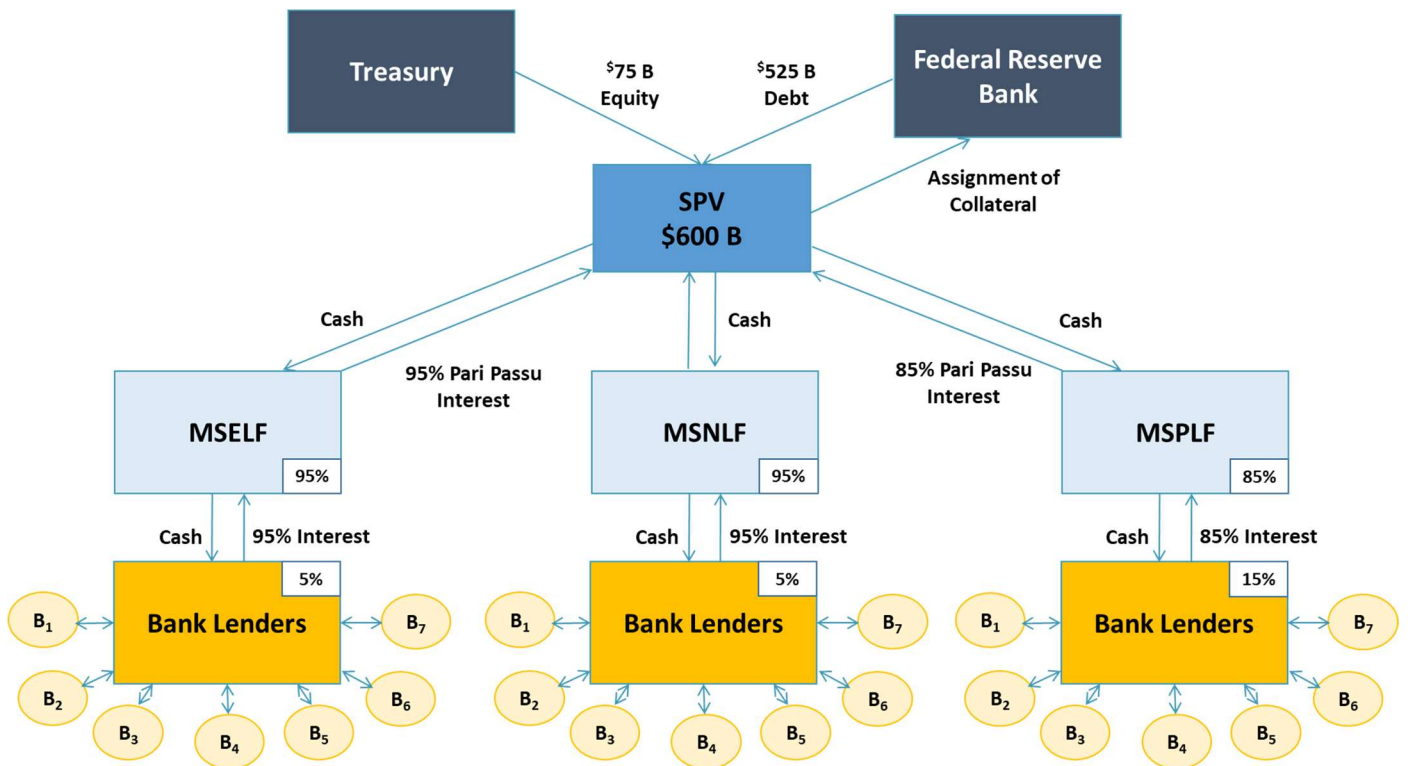
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With these changes, the MSLP will now consist of three related facilities – the Main Street New Loan Facility (MSNLF), the Main Street Expanded Loan Facility (MSELF), and the Main Street Priority Lending Facility (MSPLF). This \$600 billion program is intended to provide liquidity to U.S. insured depository institutions, bank holding companies, thrift holding companies, and the U.S. branches, agencies or interim bank holding companies of foreign banks (collectively referred to as Eligible Lenders) so that they can provide funding to small and mid-sized businesses. The Eligible Lenders will each be responsible for originating eligible loans (Eligible Loans) to eligible borrowers (Eligible Borrowers) that will be sold to a single common special purpose vehicle (SPV) funded by a \$75 billion equity commitment from the U.S. Treasury and \$525 billion in funding from the Federal Reserve Bank. In the case of the MSNLF and the MSELF, the originating Eligible Lender will retain a 5% participation in each loan sold while the SPV will own a 95% interest that it will purchase at par value. With the MSPLF, the Eligible Lender will retain a 15% participation in each loan sold while the SPV will purchase an 85% participation in the loans secured by all the assets of the SPV. The Eligible Lender and the SPV will share risk on a pari passu basis. As such, each Eligible Lender is strongly incented to originate loans to mid-sized business with due care as consistent with the lender’s existing loan policies and procedures.

As illustrated below in Chart A, the Treasury will contribute \$75 billion of equity with the Federal Reserve Bank contributing \$525 billion of debt for total available funding of \$600 billion. The SPV funding will be collateralized by a pledge of the loans but the Eligible Lender will only be at risk for its 5% participation in retained risk for the MSNLF and MSELF programs and 15% for the MSPLF. The Eligible Lender will be responsible for originating, underwriting and servicing the loans from borrowers described below as B1- B7.

Chart A - Main Street SPV Structure (MSNLF, MSELF, and MSPLF)



The basic borrower eligibility requirements, loan pricing, and servicing fees are the same for all three facilities. The MSNLF and MSPLF are designed for smaller companies with the minimum loan size of \$500,000. The MSNLF is focused on lower risk/lower leverage companies with a 5% retained risk, level principal repayment of 33 1/3% in years 2 to 4, and maximum loan size limited to the lesser of \$25 million or 4x pro forma EBITDA. The MSPLF targets higher risk/higher leverage companies with a 15% retained risk, a balloon payment of 70% of principal in year four, and maximum loan size limited to the lesser of \$25 million or 6x pro forma EBITDA.

A summary of the similarities and differences between the Main Street Lending Program alternatives is shown below in Chart B.

Chart B - Main Street Lending Program Requirements

Main Street Lending Programs			
Requirement	MSNLF	MSELF	MSPLF
Min Loan Amount	\$500,000	\$10,000,000	\$500,000
Max. Loan Amount, Lesser of:			
- Amount or	\$25,000,000	\$200,000,000	\$25,000,000
- % Existing and Undrawn Pari Passu Debt (1) or	N/A	N/A	35.00%
- Pro Form EBITDA Multiple (2)	4x	6x	6x
Credit Facility (secured or unsecured) (3)	Term Loan	Term Loan/Revolver	Term Loan
Funding Type	New Loan	Expanded Loans	New Loan
Loan Risk Classification @12/31/19	Pass	Pass	Pass
Assessment of Borrower's Financial Condition	Required	Required	Required
Eligible Lender Retained Interest	5.00%	5.00%	15.00%
SPV Retained Interest	95.00%	95.00%	85.00%
Interest Rate (1 month or 3 month)	LIBOR + 3%	LIBOR + 3%	LIBOR + 3%
Fees (4):			
- Loan Origination (Borrower to Lender)	1.00%	0.75%	1.00%
- Servicing (p.a.) (SPV to Lender)	0.25%	0.25%	0.25%
- SPV Facility (p.a.) (Lender to SPV)		0.75%	
- SPV Facility (p.a.) (Borrower to Lender)		0.75%	
Payment Terms:			
- Final Maturity (No prepay penalty)	4 years	4 years	4 years
- Year One (No principal, unpaid int. capitalized)	\$0	\$0	\$0
- Year Two	33.33%	15.00%	15.00%
- Year Three	33.33%	15.00%	15.00%
- Year Four	33.33%	70.00%	70.00%
Borrower Eligibility:			
- Business established before 3.13.20	YES	YES	YES
- Cannot be ineligible business (per SBA rules)	YES	YES	YES
- Employees < 15K or 2019 Revenue < \$5 B	YES	YES	YES
- Must be U.S. business	YES	YES	YES
- Participate in only one MS facility or the PMCC	YES	YES	YES
- No other CARES Act (Sub A -Title IV) support	YES	YES	YES
- Must make all required certifications	YES	YES	YES

- (1) 35% of the borrower's existing outstanding and undrawn available debt that is pari passu in priority with the loan and equivalent in status.
- (2) Amount that when added to outstanding and undrawn available debt, does not exceed the multiple of adjusted 2019 EBITDA shown in the chart.
- (3) For MSELF, expanded loans must have a remaining maturity of at least 18 months and be senior or pari passu with existing debt. For MSNLF and MSPLF, the loan must be senior to or pari passu in terms or priority and security with the Eligible Borrower's other loans or debt instruments, other than mortgage debt.
- (4) Loan origination fee of 1% paid on the full loan amount by the Eligible Borrower to the Eligible Lender. Servicing fee of .25% paid annually by the SPV to the Eligible Lender on the SPV purchase amount. Facility fee of .75% paid by Eligible Lender to the SPV on the SPV purchase amount but the Eligible Lender may require reimbursement from the Eligible Borrower.

As illustrated in Chart B above, the MSELF is designed for much larger companies with a minimum loan amount of \$10 million and a maximum loan amount equal to the lesser of: (i) \$200 million; (ii) 35% of the borrower's existing outstanding and undrawn available debt that is pari passu in priority with the loan and equivalent in secured status, or (iii) an amount that when added to outstanding and undrawn available debt does not exceed 6x pro forma EBITDA. For ease of calculation, the existing and undrawn available debt includes all amounts borrowed under the 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 calculated as of the date of loan application, but excludes all undrawn backup commercial paper lines, undrawn commitments for finance receivables, undrawn commitments that cannot be used without providing additional collateral, and undrawn commitments that are no longer available due to changes in circumstances.

The MSELF includes an annual facility fee of .75% payable by the Eligible Lender on the amount sold to the SPV. Eligible Lenders will likely require that borrowers pay this fee, resulting in no net cost to Eligible Lenders. Eligible Lenders using the MSELF will receive total fees consisting of loan origination fees of .75% on the total loan amount payable by the Eligible Borrower and .25% of the SPV participation amount payable each year by the SPV. Eligible Lenders under the MSNLF and MSPLF will receive loan origination fees of 1.00% of the total loan amount payable by the Eligible Borrower and .25% of the amount sold to the SPV payable each year by the SPV. Please note that Eligible Borrowers can only avail themselves of one of the MSNLF, MSELF, MSPLF or the Primary Market Corporate Credit Facility (PMCCF).

All MSLP facilities require that the Eligible Lender and Eligible Borrower make extensive attestations as follows:

- Eligible Lenders: attest that proceeds will not be used to repay or refinance pre-existing loans or lines of credit; will not cancel or reduce any existing lines of credit outstanding to the Eligible Borrower; certify EBITDA methodology; and certify compliance with conflicts of interest prohibition in Section 4019(b) of the CARES Act.
- Eligible Borrowers: must attest that proceeds will not be used to repay other loans and will commit to not pay other debt (other than mandatory principal payments) of equal or lower priority until the Eligible Loan is repaid in full; attest that it will not cancel or reduce any of its outstanding lines of credit; certify that it has the ability to meet its financial obligations and will not declare bankruptcy within 90 days after closing; attest that it will follow the compensation, stock repurchase, and capital distribution restrictions under Section 4003(c)(3)(A)(ii) of the CARES Act; and certify compliance with the conflicts of interest prohibition in Section 4019(b) of the CARES Act.

Note that Eligible Borrowers were originally required to certify that they met the EBITDA leverage requirements, required financing due to the COVID-19 pandemic, and would use reasonable best efforts to maintain payroll and retain employees during the term of the eligible loan. With the April 30 overhaul, these requirements were modified. The responsibility for the calculation of EBITDA shifted from the Eligible Borrower to the Eligible Lender, who must certify that the EBITDA methodology is consistent with other credit facilities with Eligible Borrowers and current industry practice for similar borrowers. There is no requirement to certify that the financing is needed because of the COVID-19 crisis. The requirement to maintain payroll has shifted from a certification that it "will" to a representation that it "should" make commercially reasonable efforts to maintain its payroll and its employees during the time the MSLP loan is outstanding.

The Section 4003(c)(3)(A)(ii) restrictions of the CARES Act remain unchanged and are very significant. For a period until 12 months after repayment of the Eligible Borrower's loan, the borrower would be restricted from paying dividends or other distributions on common stock and, if listed, repurchasing an equity security. During this period, the Eligible Borrower must also comply with Section 4004 restrictions on employee compensation that limit the Eligible Borrower from increasing the compensation of any officer or employee whose total compensation exceeds \$425,000, or from offering such employee severance pay or other benefits upon termination of employment that exceeds twice the maximum total annual compensation received by that employee until one year after the loan is no longer outstanding. Office or employees making over \$3 million last year would also be prohibited from earnings more than \$3 million plus 50% of the amount their compensation last year exceeded \$3 million.

A summary of certifications and covenants for lenders and borrowers is provided below in Chart C.

Chart C - Main Street Eligible Lender and Borrower Certifications

Main Street Lending Programs		
Certifications and Covenants	Eligible Lender	Eligible Borrower
Will Not Request to Repay Eligible Debt	REQUIRED	REQUIRED
Will Not Cancel or Reduce Existing Credit Lines	REQUIRED	REQUIRED
Certify EBITDA Methodology (1)	REQUIRED	N/A
Confirm No Conflict of Interest (CARES Act 4019(b)) (2)	REQUIRED	REQUIRED
Ability to Meet Financial Obligations (3)	N/A	REQUIRED
Commit to Follow CARES Act (4003(c)(3)(A)(ii)) (4)	N/A	REQUIRED

- (1) Eligible Lenders must certify that the calculation of 2019 EBITDA is consistent with methodology used for adjusting EBITDA when extending credit to the Eligible Borrower or similarly situated borrowers as of April 24, 2020.
- (2) Eligible Lender and Eligible Borrower must certify that they are eligible to participate in the MSLP in light of conflicts of interest prohibitions in Section 4019(b) of the CARES Act.
- (3) Eligible Borrower must certify that it has a reasonable basis to believe that it has the ability to meet its financial obligations for a least the next 90 days and does not expect to file for bankruptcy during that time.
- (4) Eligible Borrower must commit to follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under Section 4003 (c)(3)(A)(ii) of the CARES Act, except that an S Corp or other pass-through entity that is an Eligible Borrower may make distributions to the extent required to make tax distributions.

The certifications required by Eligible Lenders are reasonably straightforward. The Eligible Lender will be responsible for confirming that the EBITDA methodology used to determine loan size is consistent with prior lending arrangements and industry practice. Perhaps a bigger challenge for the Eligible Lenders will be the requirement for Main Street facility debt to be senior to or pari passu with existing debt. There may be circumstances where borrowers are unable to provide additional collateral which may limit the amount of debt that can be provided by the Eligible Lenders.

The certifications required by Eligible Borrowers have been reduced somewhat as they will no longer be required to certify the EBITDA calculation but rather represent that they have the ability to meet their financial obligations. The extensive CARES Act Section 4003 requirements impose real restrictions on capital management and compensation. Given these significant requirements and restrictions for Eligible Borrowers, small and mid-sized business that have access to credit facilities on more commercially reasonable terms will be highly incented to pursue those arrangements. It is noteworthy that Treasury does not require ownership interest or equity participation in the Eligible Borrower.

Summary

For small and medium-sized businesses, the Main Street Lending Program, through its MSNLF, MSELF, and MSPLF alternatives, offers a robust framework to provide liquidity and funding for new loans or increases in current credit facilities. Informed by the flood of comment letters from lenders, borrowers, and other interested parties, the Federal Reserve overhauled the MSLP effort to expand the pool of Eligible Lenders that will provide funds to a broader group of credit worthy, small and mid-size borrowers. The challenge in completing this overhaul was to open the door to otherwise credit worthy companies that were under pressure due to the COVID-19 pandemic while avoiding problem borrowers. To accomplish this, the Fed changed the borrower requirements to exclude potential borrowers that were not “pass” credits at December 31, 2019 and exclude those borrowers who could not certify that as of the date of origination of the loan, they had the ability to meet their financial obligations for at least 90 days.

To expand the Eligible Borrower pool, the Federal Reserve allowed for higher risk borrowers through the MSPLF but required that Eligible Lenders retain a 15% rather than 5% *pari passu* interest. It also increased the size of Eligible Borrowers and the borrowing amount for the MSELF while lowering the minimum borrowing amount for the MSNLF and the MSPLF. Loans originated by banks in the MSLP are underwritten based on the originating bank’s credit standards reinforced by the *pari passu* retained interest with the SPV buying such assets. The numerous requirements for attestation and limits of dividends, buybacks and compensation that come with the MSLP would likely motivate main street business borrowers to utilize instead commercially available financing if possible.

Time will tell whether the overhaul to the Main Street Lending Program will be successful in terms of volume of funds provided to small and mid-sized businesses and losses incurred with the programs. The Federal Reserve hinted that they would consider lending using alternative credit metrics to accommodate asset-based businesses and non-profit organizations. This would certainly increase the volume of loans if not the credit quality. Treasury Secretary Mnuchin reported last week that he expects the Federal Reserve to return \$454 billion of the funds allocated by Congress in the CARES Act to support the Fed’s business lending programs due to expectations of minimal expected credit losses in the base case scenario. Hopefully, the combination of the retained risk by the Eligible Lenders with the SPV structure and revised borrower eligibility requirements will minimize expected losses on the Fed’s lending facilities. Given the strong demands for government financial support in other areas, those funds may soon be redirected for other purposes.

Please note that this report is based on information as of May 7, and the funding programs referenced above are subject to further change before implementation. We have provided below a link to the Federal Reserve website with the most current information on the MSNLF, MSELF, and MSPLF term sheets and other available information.

<https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm>

Special thanks to Brent Layman, Director – Investment Banking, Financial Services Group for his contribution to this note.

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