C L I F F O R D

C H A N C E

CORONAVIRUS UPDATE: THE US CARES ACT AND THE REVISED MAIN STREET LENDING PROGRAM

On April 30, after receiving public feedback on the initial program terms, the Federal Reserve (the "**Fed**") announced revisions to the Main Street Lending Program (the "**MSLP**") intended to expand financial support to small and mid-sized businesses that were in good financial health prior to the COVID-19 pandemic. The revisions serve to broaden some of the eligibility criteria to allow more companies and lenders to participate in the program as well as improve efficiency with existing loans, including by allowing interest to accrue at LIBOR (versus the still developing SOFR replacement). The revised MSLP also now includes three facilities – one for up to $25 million in new eligible term loans that are not subordinated to any existing debt of the borrower (referred to as the "**Main Street New Loan Facility**" or "**MSNLF**")), one for up to $25 million in new eligible priority term loans that rank senior to or pari passu with the borrower's other existing debt (referred to as the "**Main Street Priority Loan Facility**" or "**MSPLF**"), and one for up to $200 million in incremental eligible term or revolving loans that upsize the borrower's existing loan facility and rank senior or pari passu with the borrower's other existing debt (referred to as the "**Main Street Expanded Loan Facility**" or "**MSELF**" and collectively with the Main Street New Loan Facility and Main Street Priority Loan Facility, the "**Facilities**")). Despite efforts to expand and improve the terms of the MSLP, restrictions remain that make the Facilities impractical for many leveraged borrowers. The revised program also introduces new restrictions and hurdles to eligibility, in particular, incorporation of certain "affiliation rules" without the expected carveouts, which will keep this relief out of reach for certain borrowers.

A. STRUCTURE; FEDERAL RESERVE ACT REQUIREMENTS

As noted previously, the MSLP is authorized specifically by the Coronavirus Economic Stabilization Act of 2020 ("**CESA**"), enacted as Title IV, Subtitle A of the Coronavirus Aid, Relief, and Economic Security Act (the "**CARES Act**"). The program calls for the Department of the Treasury (the "**Treasury**") to make a $75 billion equity investment in a common special purpose vehicle (the "**SPV**") common to each Facility, using funds appropriated for the Treasury's Exchange Stabilization Fund. The SPV will be created by the Federal Reserve Bank of Boston and will purchase an 85% loan participation in each MSPLF loan and a 95% loan participation in each MSNLF loan and each upsized tranche of Eligible Loans (as defined below) for the MSELF, and lenders will retain the remaining exposure. Through the revised MSLP, the central bank will make available as much as $600 billion in loans for US businesses with up to 15,000 employees or up to $5.0 billion in 2019 annual revenues—a broader pool of borrowers than was contemplated under the program's initial terms. It is important to note that unlike loans guaranteed by the Small Business Administration ("**SBA**") under the Paycheck Protection Program, loans under the MSLP are not eligible for forgiveness.

B. THE FACILITIES

The Fed released a term sheet for the new MSPLF and revised term sheets for the other Facilities (available here), plus a helpful list of FAQs (available here). The key terms of the Facilities and the revised eligibility considerations are discussed below.

Eligible Lender Requirements

The term sheets specify that "Eligible Lenders" are limited to US insured depository institutions, US branches or agencies of a foreign bank, US bank holding companies, US savings and loan holding companies, US intermediate holding companies of foreign banking corporations and US subsidiaries of any of the foregoing. Initially, the MSLP omitted US-based affiliates of foreign banks altogether, but has now broadened the pool of Eligible Lenders with the latest revisions to the term sheets.

Practical Considerations:

While the Fed took into account questions and concerns regarding financing from US branches and US subsidiaries of foreign banks, the terms still omit non-bank financial institutions from the pool of Eligible Lenders. This blanket omission of non-bank lenders may exclude meaningful sources of funding in the MSLP. To this end, a borrower looking to utilize the MSELF to upsize existing loans may not be able to do so if none of the existing lenders are Eligible Lenders. This raises the question of whether a borrower can bring an Eligible Lender into the syndicate in order to provide the upsized loans. While this may appear to be a solution, restrictions in the relevant loan agreement may make doing so difficult, if not impossible. Notably, the Fed indicated it is considering options to expand the list of Eligible Lenders in the future, which could help with the foregoing dilemma.

Eligible Borrower Requirements

The changes to the MSLP expand the pool of businesses eligible to borrow by increasing the number of employees and annual revenues an Eligible Borrower may have. The updated qualifications for "Eligible Borrowers" is consistent across the Facilities:

- Must be a business established prior to March 13, 2020 with no more than 15,000 employees or up to $5 billion in 2019 annual revenues. These figures are each double the limits originally set forth in the initial term sheets.
    - Notably, calculation of the revised employee and revenue caps requires the borrower to aggregate its employees and revenues with those of its affiliates.
- Must be a business entity created or organized in the US with significant operations in and a majority of employees based in the US.

- May only participate in one of the Facilities, must not participate in the Primary Market Corporate Credit Facility and must not have received specific financial support through the CARES Act. Note that receipt of financing under the Paycheck Protection Program (the "**PPP**") does not preclude an otherwise qualified company from being an Eligible Borrower.
- Must not be listed as an "Ineligible Business" under the SBA rules.
- Companies seeking financing under the MSLP must make certain certifications required under the CARES Act, along with additional attestations with respect to each loan or upsized tranche.

Practical Considerations:

Consistent with the approach in the PPP, the Fed will now apply the SBA's affiliation rules pursuant to 13 CFR 121.301(f). The statue contains a number of bases to find affiliation and companies controlled by a common private equity sponsor meet that criteria. When it comes to the relevant calculations to determine borrower eligibility, the applicant and each affiliate is viewed as a single business for purposes of calculating the number of employees and revenues. Using the SBA framework, the business is directed to use the average of the total number of people employed by the potential borrower and its affiliates for each pay period over the 12 months prior to the origination or upsizing of the MSLP loan. Likewise, 2019 revenues are calculated by aggregating the 2019 revenues of the business itself with those of the business's affiliated entities in accordance with the affiliation test set forth in 13 CFR 121.301(f). While Title I of the CARES Act provides certain affiliation exceptions to borrowers under the PPP (e.g., for franchises, food service businesses and accommodations businesses), the term sheets do not extend these or similar exceptions to potential borrowers under the MSLP.

While changes to the MSLP are intended to expand its scope and eligibility, given the incorporation of the affiliation rules, many private equity portfolio companies that were eligible borrowers under the previous iteration of the program will find that they cannot participate in the revised program due to their common ownership. Certain portfolio companies of private equity firms may still qualify, assuming they satisfy the various borrower eligibility requirements, including affiliation.

There has been a similar simultaneous loosening and tightening of terms with respect to the required borrower attestations. The term sheets no longer require a borrower to "attest that it requires financing due to the exigent circumstances presented by" the pandemic. On the other hand, the borrower must make forward-looking certifications about its solvency. A potential borrower must certify that it has a reasonable basis to believe that, as of the date of origination of the Eligible Loan (or upsized tranche in the case of a MSELF loan) and after giving effect to such loan, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period.

Key Features and Terms of Facilities

New loans under each of the MSNLF and MSPLF and loans eligible for "expansion" under the MSELF ("**Eligible Loans**") must meet the following requirements:

- Eligible Loans under the MSNLF and the MSPLF must be term loans originated after April 24, 2020.
- Eligible Loans that may be upsized under the MSELF must be existing secured or unsecured term loans or revolving credit facilities originated on or before April 24, 2020, with at least 18 months remaining until maturity.

  Practical Considerations:

  Although the MSELF has been expanded to include upsized tranches of revolving credit facilities, in addition to previously authorized term loans, the practical effect of such expansion may be limited. Eligible Borrowers will likely find the possibility of adding new tranches to their existing term loans more desirable than upsizing their existing revolvers. It may be impractical to incorporate term loan technology into an existing revolving credit facility that does not already have such technology built in.

Eligible Loans under each of the MSNLF and MSPLF and upsized tranches of Eligible Loans under the MSELF must contain the following terms:

- <u>Maturity</u>: 4 years
- <u>Amortization</u>: Principal and interest deferred for one (1) year, but any unpaid interest in year 1 will be capitalized.
  - For MSNLF loans: 1/3 at end of years 2, 3 and 4 (maturity).
  - For MSPLF and MSELF loans: 15% at end of years 2 and 3, 70% at end of year 4 (maturity)
- <u>Interest rate</u>: Adjustable rate of LIBOR (1 or 3 month) + 300 basis points

  Practical Considerations:

  The initial terms sheets indicated that the interest rates for both new loans and upsized tranches would be based on SOFR. Based on feedback and widespread doubt as to whether a transition to SOFR during the COVID-19 pandemic was feasible or an otherwise efficient use of already strained resources, the Fed revised the interest rate to track the well-followed LIBOR benchmark, but requires that the parties include fallback language in the loan documents. Note that in the UK, comparable government relief loans are being linked to sterling backed LIBOR in lieu of the successor rate for similar reasons. This change to LIBOR will help improve efficiency and speed in terms of execution.

  In respect of the MSELF*, however, incorporating maturity and amortization requirements for upsized loans may still prove challenging in light of the terms and protections governing any existing loans.*

- <u>Minimum size</u>: For MSNLF and MSPLF loans, $500,000; for MSELF loans, $10 million.
- <u>Maximum size</u>:
  - or MSNLF loans, no greater than the lesser of:
    - (i) $25 million; and

    - (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 4x the borrower's 2019 adjusted EBITDA.

  - For MSPLF loans, no greater than the lesser of:
    - (i) $25 million; and
    - (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 6x the borrower's 2019 adjusted EBITDA.
  - For MSELF loans, no greater than the lesser of:
    - (i) $200 million;
    - (ii) 35% of the borrower's existing outstanding and committed but undrawn bank debt that ranks pari passu in priority and secured status with the Eligible Loan; and
    - (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 6x the borrower's 2019 adjusted EBITDA.

Practical Considerations:

EBITDA is the key metric for underwriting loans issued under the MSLP and determining the maximum loan amount available under a Facility. One of the more significant changes to the program is the clarification that the Facilities permit use of adjusted EBITDA where appropriate. An Eligible Lender must calculate EBITDA in a manner consistent with how it calculated the Eligible Borrower's adjusted EBITDA when it previously extended credit to the Eligible Borrower or originated/amended the underlying loan with such borrower, or if the Eligible Lender has not previously extended credit to the Eligible Borrower, in a manner consistent to how it extended credit to similarly situated borrowers, in both cases, applicable before April 24, 2020. Permitting Eligible Borrowers to use adjusted EBITDA enables a broader group of companies to utilize the Facilities than initially expected, when looking at the debt to EBITDA distribution for large cap deals, but the Fed also acknowledged that this metric does not accommodate asset-based borrowers and is considering whether to develop an alternative underwriting metric.

If an Eligible Lender has an existing loan outstanding with the Eligible Borrower as of December 31, 2019, such lender must take additional measures to evaluate the borrower's financial condition. The lender must confirm that the existing loan had an internal risk rating (based on the Eligible Lender's risk assessment protocol) equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system as of that date. While the term sheets provide minimum eligibility requirements for borrowers and certain underwriting standards for lenders, Eligible Lenders are tasked with applying their own underwriting standards in evaluating the creditworthiness of otherwise Eligible Borrowers.

- <u>Prepayment Premium</u>: None.

- Collateral/Priority: Eligible Loans under the MSNLF and MSPLF and upsized tranches of Eligible Loans under the MSELF may be secured or unsecured, subject to the priority requirements listed below.
    - For MSNLF loans: Eligible Loans cannot at any time be contractually subordinated to the borrower's other indebtedness (i.e., must be at least senior unsecured).
    - For MSPLF and MSELF loans: New Priority Loans and upsized tranches under the MSELF must at all times rank senior or pari passu with the borrower's other indebtedness (not including mortgage debt), in terms of both payment and lien priority. Any collateral securing an upsized tranche under the MSELF (whether pledged in connection with the original loan or the new tranche) will secure the SPV's participation on a pro rata basis.

    Practical Considerations:

    These requirements may require a new or amended intercreditor agreement among the borrower's creditors. To this end, some existing debt structures may prove challenging when seeking to honor the priority and collateral requirements of the MSELF. In particular, in a typical split-collateral structure, an ABL would have priority liens on working capital assets and the term loan would have priority liens on all other assets and equity interests. It remains to be seen if the Fed will offer further guidance with respect to these structures, which small and medium sized businesses that are the intended beneficiaries of this program often use.

- Fees:
    - *Origination/Upsize Fee*: Borrower to pay lender 100 basis points (for MSNLF and MSPLF loans) and 75 basis points (for MSELF loans) of the principal amount of the new Eligible Loan or upsized tranche of an existing Eligible Loan at time of origination/upsizing.
    - *Servicing Fee*: SPV to pay lender 25 basis points of the principal amount of its participation in the new loan/upsized tranche per annum.
    - *Facility Fee*: Lender to pay (or require borrower to pay) the SPV 100 basis points (for MSNLF loans and MSPLF loans) or 75 basis points (for MSELF loans) of the principal amount of the new Eligible Loan or upsized tranche of an existing Eligible Loan at the time of origination.
- Assignability: The Facilities permit lenders to assign their 5% or 15% retained risk in a loan/upsized tranche under a Facility but not until (a) for new loans under the MSNLF or MSPLF, the earlier of the new loan's maturity or the date that the SPV sells its participation in such loan and (b) for upsized tranches under the MSELF, the earlier of the underlying Eligible Loan's maturity date or the date that the SPV sells its participation in the upsized tranche.

Practical Considerations:

It is clear that without the ability to assign interest in a loan, many lenders would be discouraged to lend under the Facilities. The revised terms seek to address this, but raise a new slew of questions. It is not clear what the terms of the newly created participation agreement between the lenders and the SPV will look like, particularly in terms of voting rights and predictability as to how will a government SPV act.

- Other Key Terms: As noted in our earlier briefing, borrowers may not (i) use the proceeds of the MSLP loans to repay or refinance existing debt (now with an exception for using MSPLF loans to refinance existing loans of non-Eligible Lenders), (ii) prepay any equal or lower priority debt before repaying amounts owed under the relevant facility in full (except debt and interest payments that are mandatory and due under such other debt facilities and repayment of lines of credit in the ordinary course) and (iii) in the context of direct/bilateral loans, pay any dividends (subject to a new exception for certain borrower entities necessary to cover tax-related obligations).

The Fed has yet to announce a start date for the MSLP, and we expect that the Fed and the Department of the Treasury may make further adjustments to the terms that are described herein. We will continue to monitor developments as the facilities are further developed.

Our briefings on "Coronavirus: The Economic Stabilization Provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act" and other Coronavirus (Covid-19) materials can be found here:

https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html

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