COVID-19 – The Main Street Lending Program: New May 2020 Guidance and Forms from Federal Reserve Bank of Boston

June 2, 2020

As discussed in our previous Client Alert, The Main Street Lending Program ("Main Street" or the "Program") is a financial assistance program established by the Board of Governors of the Federal Reserve System to support small and medium-sized businesses affected by the COVID-19 pandemic. Although the Program was announced shortly following the enactment of The Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") and incorporates certain of its terms, the Program is actually an emergency lending program established by the Federal Reserve under section 13(3) of the Federal Reserve Act.

The Program authorizes eligible lenders to originate up to $600 billion in eligible loans through three separate facilities - the Main Street New Loan Facility (the "New Facility"), the Main Street Priority Loan Facility (the "Priority Facility"), and the Main Street Expanded Loan Facility (the "Expanded Facility" or "MSELF"). A special purpose vehicle ("SPV") formed by the Federal Reserve will purchase 85% or 95% participations in these loans. Please consult our previous Client Alert for additional details on the Program terms previously announced.

On May 27th, 2020, the Federal Reserve Bank of Boston (which is administering the Program) issued a revised Frequently Asked Questions ("FAQ") document on the Program, which updated the prior April 30th FAQ guidance, along with forms of various documents required for the Program, including the forms of loan participation agreement, co-lender agreement, loan servicing agreement, borrower and lender transaction certifications and covenants, and lender registration materials. This Client Alert summarizes certain of the more significant clarifications and updates to the Program terms previously announced.

The Federal Reserve is currently working to create the infrastructure necessary to operationalize the Program, which is anticipated to launch in the first week of June.

ELIGIBLE LENDERS

The new guidance provides a number of clarifications regarding lender eligibility criteria under the existing terms of the Program.

Interest in the Underlying Loan

Under the existing terms of the Program, a lender participating in the Expanded Facility must hold an interest in the underlying loan at the time of the upsizing. The new guidance clarifies that a MSELF lender is not required to have originally extended the underlying loan, provided that such lender purchased its interest in the underlying loan on or before December 31, 2019.

No Syndication of 5% MSELF Retention

If the underlying loan is part of a multi-lender facility, the MSELF lender must retain a full 5% of the upsized tranche and cannot share such 5% retention with other members of the multi-lender facility.

Lender Registration

Prior to making any Main Street loans, the lender will be required to register with the SPV. The form of Lender Registration Certifications and Covenants provided includes lender certifications and covenants regarding its being an eligible lender under the Program, its eligibility under the CARES Act conflicts of interest prohibition and its solvency. The lender is also required to complete and submit a Lender Wire Instructions form for any payments it will receive in connection with the Program.

ELIGIBLE BORROWERS

The new guidance also provides a number of clarifications regarding borrower eligibility criteria under the existing terms of the Program.

U.S. Business Requirement

Significant Operations in the United States

One of the borrower eligibility criteria under the existing terms of the Program is that the proposed borrower has "significant operations" in the United States. The new guidance provides, as a non-exhaustive list of examples, that operations that satisfy this criteria include when greater than 50% of the proposed borrower's:

- assets are located in the United States;
- annual net income is generated in the United States;
- annual net operating revenues are generated in the United States; or
- annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) are generated in the United States.

For purposes of these calculations, the borrower's operations should be consolidated with those of its subsidiaries, but not its parent companies or sister affiliates.

U.S. Subsidiaries of Foreign Companies

A borrower that is a subsidiary of a foreign company may be eligible for the Program if it meets the U.S. business requirements. However, it must use the proceeds of a Main Street loan only for the benefit of itself and its affiliates or subsidiaries that are U.S. businesses. The proceeds of a Main Street loan may not be used for the benefit of a borrower's foreign parents, affiliates or subsidiaries.

Affiliation Rules

Borrower Participation in Other Main Street or CARES Act Programs

One of the borrower eligibility criteria under the existing terms of the Program is that the borrower cannot borrow under more than one Main Street Facility or certain other CARES Act programs, such as the Primary Market Corporate Credit Facility ("PMCCF"). The new guidance clarifies that affiliation rules apply in this determination. Thus, an affiliated group of companies can participate in only one Main Street facility, and cannot participate in both a Main Street facility and the PMCCF.

Maximum Loan Size

An affiliated group's total participation in a single Main Street facility cannot exceed the maximum loan size applicable for that affiliated group. In addition, the maximum loan size for a borrower will be limited based not only on its own leverage, but on the leverage of its affiliates (on a consolidated basis). See "Maximum Loan Size" below.

Ineligible Entities - Private Equity Funds

One of the borrower eligibility criteria under the existing terms of the Program is that the borrower must not be an "Ineligible Business" under applicable Small Business Administration ("SBA") rules. The new guidance clarifies that the SBA has determined that private equity funds are primarily engaged in investment or speculation, and are therefore ineligible businesses. See SBA PPP Interim Final Rule at 85 Fed. Reg. 23450 (released by the SBA on April 24, 2020).

Affiliation Rules – Impact on Portfolio Companies of Private Equity Fund

One of the borrower eligibility criteria under the existing terms of the Program is that the borrower and its affiliates collectively either have 15,000 or fewer employees or 2019 annual revenues of $5 billion or less. The new guidance clarifies that, in measuring such employees and revenues, the SBA affiliation rules applies to private equity-owned businesses in the same manner as any other business subject to outside ownership or control.

FEATURES OF ELIGIBLE LOANS

Loan Size

Under the existing terms of the Program, all loans are subject to a maximum size equal to a fixed amount ($200 million for MSELF loan upsizes and $25 million for other Main Street loans) or such lesser amount as would be permitted under certain leverage-based tests. The new guidance provides a number of clarifications regarding these size limitations, as set forth below.

Maximum Loan Size – Impact of Affiliates Leverage

The maximum loan size for a borrower will be limited based not only on its own leverage, but on the leverage of its affiliates (on a consolidated basis). In an example included in the FAQs, a borrower's maximum loan size under the New Facility would be the lesser of:

- $25 million (less any amount extended to an affiliate of the borrower under the New Facility);
- an amount that, when added to the borrower's existing outstanding and undrawn available debt, does not exceed four times the borrower's adjusted 2019 EBITDA; or
- an amount that, when added to the borrower's affiliated group's existing outstanding and undrawn available debt, does not exceed four times the affiliated group's adjusted 2019 EBITDA.

Maximum Loan Size – MSELF 35% Limit

One of the leverage tests for a MSELF upsized tranche is that it cannot exceed 35% of the borrower's existing outstanding and undrawn available debt that is pari passu in priority with and equivalent in secured status (i.e., secured or unsecured) to the MSELF upsized tranche. The new guidance clarifies that this calculation requires the inclusion of debt as follows:

- in the case of a secured MSELF loan upsize, all of the borrower's secured debt for borrowed money (regardless of the value or type of collateral) that has not been made junior in priority to the MSELF upsized tranche through contractual subordination; and
- in the case of an unsecured MSELF loan upsize, all of the borrower's unsecured debt for borrowed money that has not been made junior in priority to the MSELF upsized tranche through contractual subordination.

> ***Observation**: This theoretically enables a borrower for a secured MSELF loan upsize to bypass the 35% leverage cap by either (i) using a secured upsized tranche to upsize an unsecured underlying loan, or (ii) contractually subordinating a secured underlying loan to a secured upsized tranche. However, ether approach would likely require the approval of the lenders participating in the underlying loan, who may have little incentive to consent.*

EBITDA Adjustment Methodology

All of Program options use leverage tests based on the borrower's adjusted 2019 EBITDA, with EBITDA adjusted using the methodology that the lender previously used when extending credit to the borrower or similarly situated borrowers on or before April 24, 2020. The new guidance provides a number of clarifications here:

- If the borrower is an existing customer of the lender, then the lender must use the methodology that it previously used when extending credit to the borrower. If the borrower is a new customer, then the lender is to use an EBITDA adjustment methodology used for similarly situated borrowers.
- If a lender has used multiple EBITDA adjustment methods for the borrower or similarly situated borrowers (e.g., one for use within a credit agreement and one for internal risk management purposes), it should choose the most conservative method it has employed.

The lender must select a single method used at a point in time in the recent past (before April 24, 2020), and may not "cherry pick" or apply adjustments used at different points in time or for a range of purposes.

- When the lender originates a Main Street loan, it should document the rationale for its selection of an adjusted EBITDA methodology and, if based a methodology used for similarly situated borrowers, its process for identifying similarly situated borrowers.

"Similarly situated borrowers" means borrowers in similar industries with comparable risk and size characteristics.

2019 EBITDA for Selected Subsidiaries of Holding Companies

If the borrower is a holding company, all or substantially all of the assets of which comprise equity interests in other entities, then the EBITDA leverage test used to determine maximum loan size is based only on the adjusted 2019 EBITDA of its "Selected Subsidiaries" – i.e., operating subsidiaries which provide a guarantee for the Main Street loan on a joint and several basis and meet the other eligibility criteria for the applicable Main Street facility.

Priority Requirements

Under the existing terms of the Program, Priority Facility loans and MSELF loan upsizes must be senior to or pari passu with, in terms of priority and security, all of the borrower's other loans or debt instruments other than mortgage debt (hereinafter, "Non-Mortgage Debt"). The new guidance provides a number of other clarifications regarding these priority and security terms, as set forth below.

Definitions – "Loans or Debt Instruments" and "Mortgage Debt"

The new guidance defines "loans or debt instruments" as debt for borrowed money and all obligations evidenced by bonds, debentures, notes, loan agreements or other similar instruments, and all guarantees of the foregoing. And "mortgage debt" is defined as debt secured by real property at the time of the Main Street loan's origination.

No Contractual Subordination

At the time of origination, the Priority Facility loan or MSELF loan upsize (whether secured or unsecured) must not be contractually subordinated in terms of priority to any of the borrower's Non-Mortgage Debt. The loan documentation must include covenants to ensure that such contractual subordination is not permitted at any time that the Priority Facility loan or MSELF loan upsize is outstanding.

Shared Collateral and Collateral Coverage Ratio

Priority Facility loans and MSELF loan upsizes can be unsecured only if the borrower does not have, as of the date of origination, any secured Non-Mortgage Debt. Otherwise, the Priority Facility loan or MSELF loan upsize must be secured.

In the case of a Priority Facility loan, although it need not share in all of the collateral that secures the borrower's other Non-Mortgage Debt:

- it must have a Collateral Coverage Ratio (as defined below) at the time of origination equal to the lesser of (i) 200% or (ii) the aggregate Collateral Coverage Ratio for all of the borrower's other Non-Mortgage Debt; and
- to the extent of any shared collateral, it must be and remain senior to or pari passu with the liens of the other Non-Mortgage Debt creditors upon such collateral.

"Collateral Coverage Ratio" is defined as the percentage obtained by dividing (a) the aggregate value of any collateral security, including the pro rata value of any shared collateral, for the relevant debt (e.g., the Priority Facility or other Non-Mortgage Debt), divided by (b) the outstanding aggregate principal amount of the relevant debt.

***Observations**:*

(1) The Collateral Coverage Ratio requirement is being introduced to the Program for the first time with these FAQs, and it includes many ambiguities. For example, it is not clear how collateral would be valued for purposes of calculating the Collateral Coverage Ratio or at what point in time collateral would be measured. Nor does the new guidance address how to calculate pro-rata value for any shared collateral.

(2) The Collateral Coverage Ratio requirement appears to only pertain to Priority Facility loans made to a borrower that has other Non-Mortgage Debt that is secured and not being refinanced.

(3) For a borrower with property which is subject to asset specific financing (such as equipment, inventory or receivables), the borrower might not be permitted to subject such property to the lien of a Priority Facility lender absent the consent of, or contractual subordination in favor of, the existing asset specific creditor. The new Collateral Coverage Ratio approach potentially allows a Priority Facility loan to exclude such problematic property from its collateral. The practical utility of this new Program term remains to be seen in light of the potentially high (up to 200%) Collateral Coverage Ratio.

In the case of a MSELF upsized tranche, it must be secured by the collateral securing any other tranche of the underlying credit facility on a pari passu basis. The lenders may add new collateral to secure the MSELF upsized tranche and, if desired, the underlying loan (on a pari passu basis) at the time of upsizing. If the underlying credit facility includes both term loan tranches and revolver tranches, the MSELF upsized tranche needs to share collateral on a pari passu basis with the term loan tranches only.

<u>Lien Covenants</u>

The loan documents for all Main Street loans must contain a lien covenant or negative pledge that is of the type – and contains exceptions, limitations, carve-outs, baskets, materiality thresholds, and qualifiers – consistent with those used by the lender in its ordinary course lending to similarly situated borrowers. The new guidance includes a sample lien covenant in Appendix B to the FAQs. In the case of MSELF loan upsizes of syndicated loans, any lien covenant that was negotiated in good faith prior to April 24, 2020, as part of the underlying loan, is sufficient to satisfy this requirement.

MSELF Upsizes Must be Term Loans

Under the April 30th Term Sheet for the MSELF facility, an "Eligible Loan" is defined in part as "a secured or unsecured term loan or revolving credit facility…" However, this was contradicted by item A.4 of the April 30th FAQs, which seemingly indicated that, although the MSELF facility enables a borrower to upsize either a term loan or a revolving credit facility, the upsized tranche itself must be a term loan.

The new guidance includes a Loan Documents Checklist table (see "ADDITIONAL MATTERS FOR LENDERS - Loan Documents" below) in which the permitted loan type row is consistent with item A.4 of the April 30th FAQs, apparently confirming that a MSELF upsized tranche must be a term loan.

REQUIRED REPRESENTATIONS AND COVENANTS

Prior guidance had generally described certain certifications and covenants that participating borrowers and lenders would be required to make pursuant to the Program. The Federal Reserve Bank of Boston has now released the official forms of Borrower Certifications and Covenants and Lender Certifications and Covenants that will be required to be submitted for each Main Street loan. These forms include instructions, and the FAQs have also been updated to provide new guidance on their requirements.

Borrower Certifications and Covenants

Under the newly released Borrower Certifications and Covenants forms, the borrower must certify that it meets the Program's borrower eligibility criteria (e.g., it is a "Business", not an "Ineligible Business", satisfies the U.S. business requirements, meets the employees/revenues size test, has not participated in specified CARES Act programs, is solvent, etc.) and the requirements of the Program facility it has selected. The borrower must also agree to comply with certain covenants required by the existing Program terms, including the restrictions on repayment of debt and the CARES Act restrictions on compensation, stock repurchases and capital distributions. The form also provides for the borrower to indemnify the lender, the SPV and certain other beneficiaries for any losses arising out of a material breach of any of these certifications or covenants.

Unavailability of Adequate Credit Accommodations

A key new requirement under the new Borrower Certifications and Covenants forms is that the borrower will be required to certify that it is "unable to secure adequate credit accommodations from other banking institutions." Such inability is a requirement for emergency lending program under section 13(3) of the Federal Reserve Act, but had not been a borrower requirement in the April 30th, 2020 Term Sheets or related guidance.

The new guidance clarifies that being unable to secure adequate credit accommodations does not mean that no credit from other sources is available to the borrower. Rather, the borrower may certify that it is unable to secure "adequate credit accommodations" because the amount, price, or terms of credit available from other sources are inadequate for the borrower's needs during the current unusual and exigent circumstances. Borrowers are not required to demonstrate that applications for credit had been denied by other lenders or otherwise document that the amount, price or terms of credit available elsewhere are inadequate.

Observations:

(1) This appears to be the only needs based requirement in the new guidance. It would seem difficult to objectively determine whether this criteria has been satisfied for many borrowers, resulting in inherent uncertainty as to how a borrower will in good faith make such determination.

(2) If there is a material misstatement in the borrower certification that it meets this requirement, the Federal Reserve may require the borrower to prepay the Main Street loan in full within two business days. See "Breaches of Borrower Certifications and Covenants" below.

Mandatory and Due Debt Payments

As suggested in prior guidance, the Borrower Certifications and Covenants forms include debt repayment covenants that generally prohibit a borrower from repaying the principal balance of, or paying any interest on, any debt until the Main Street loan is repaid in full, unless the principal or interest payment is mandatory and due. The new guidance clarifies that, with respect to debt that predates the Main Street loan, principal and interest payments are "mandatory and due" as follows:

- on or after the scheduled payment due date, provided that the payment due date was scheduled prior to April 24, 2020; or
- upon the occurrence of an event that automatically triggers mandatory prepayments under a contract for indebtedness that the borrower executed prior to April 24, 2020, except that if the borrower has an existing debt arrangement that requires prepayment upon the incurrence of new debt:
    - the borrower can prepay such debt using Priority Facility loan proceeds at the time of origination; and
    - otherwise, the borrower cannot prepay more than a de minimis amount and, in order to obtain a Main Street loan, must have such requirement waived or reduced to a de minimis amount by the relevant creditor.

For future debt incurred by the borrower in compliance with the terms and conditions of the Main Street loan, principal and interest payments are "mandatory and due" on their scheduled dates or upon the occurrence of an event that automatically triggers mandatory prepayments.

> ***Observation**: Although new debt may be incurred after a Main Street loan is originated, the mandatory lien covenants would, subject to limited exceptions (including, for example, if the new debt is secured by collateral that does not secure the Main Street loan), require such new debt to be either unsecured or subordinated to the Main Street loan. See "FEATURES OF ELIGIBLE LOANS – Priority Requirements" above.*

Refinancing of Debt

The prior guidance stated that the debt payment restrictions (see "Borrower Certifications and Covenants - Mandatory and Due Debt Payments" above) would not prevent a borrower from refinancing maturing debt. The language in the Borrower Certifications and Covenants clarifies that this allows for the refinancing of debt that is maturing no later than 90 days from the date of such refinancing.

Breaches of Borrower Certifications and Covenants

The new guidance provides that the loan documents must contain a mandatory-prepayment provision related to a material breach of the Borrower Certifications and Covenants (see "ADDITIONAL MATTERS FOR LENDERS - Loan Documents" below). If the Federal Reserve determines that a borrower made a material misstatement in certifications, or materially breached covenants, relating to CARES Act, the Federal Reserve Act, or the Board's Regulation A, then the Federal Reserve may notify the lender and the borrower will then be required to prepay the Main Street loan in full within two business days. The Borrower Certifications and Covenants also includes an acknowledgement that the SPV, the Federal Reserve or the Department of the Treasury may refer any knowing material misrepresentation by the borrower to relevant law-enforcement authorities for investigation and possible action in accordance with criminal and civil law.

A lender has certain obligations of due inquiry with respect to the borrower, including:

- as to the borrower's formation date;
- that the borrower meets the Program's definition of a "Business";
- in the case of an unsecured Priority Facility loan or MSELF loan upsize, due inquiry as to liens (i.e., lien searches) to confirm that the borrower has no secured Non-Mortgage Debt;
- in the case of a secured Main Street loan or loan upsize:
    - o due inquiry as to liens (i.e., lien searches) to confirm that the lien of the lender in any shared collateral is senior to or pari passu with the lien on such Shared Collateral that secures any of the borrower's other secured Non-Mortgage Debt; and
    - o due inquiry as to debt to confirm that the Collateral Coverage Ratio is satisfied, if applicable. This requires inquiry of the lender's officers and employees that manage its relationship with the borrower and a reasonable search of the lender's records.

Otherwise, a lender assumes no responsibility for independently verifying the accuracy of such borrower certifications and may rely entirely on the Borrower's certifications. The lender is also not expected to monitor the borrower's ongoing compliance with covenants set out in the Borrower Certifications and Covenants, but is expected to promptly notify the SPV and the Federal Reserve if it becomes aware of a Borrower's material breach of such covenants as a result of the Borrower self-reporting.

Lender Certifications and Covenants

Under the newly released Transaction Specific Lender Certifications and Covenants form, the lender must certify that the proposed Main Street loan is eligible for the Program facility that was selected, and that the loan documents have all of the terms required for such facility. See "ADDITIONAL MATTERS FOR LENDERS – Loan Documents" below.

The lender must also agree that it will not require that the proposed Main Street loan be used to pay off the borrower's existing debt to the lender except as permitted by the Program terms (see "Borrower Certifications and Covenants - Mandatory and Due Debt Payments" above), and it will not cancel or reduce the borrower's existing lines of credit with the lender.

Reliance on Borrower Certifications and Covenants

For borrower specific information, the lender may generally rely upon the Borrower Certifications and Covenants without independently verifying its contents or actively monitoring ongoing compliance therewith. However, the lender must conduct due inquiry with respect to the borrower's formation date and meeting the Program's definition of a "Business," and must see financial records supporting the EBITDA and leverage calculations.

Also, as per the prior Program guidance, the lender is expected to assess a potential borrower's financial condition and creditworthiness at the time of initial application. And if the borrower had other loans outstanding with the lender as of December 31, 2019, the lender must certify that such loans had an internal risk rating equivalent to a "pass".

Repayment of Line of Credit with Lender

The prior guidance stated that the debt payment restrictions (see "Borrower Certifications and Covenants - Mandatory and Due Debt Payments" above) would not prevent a borrower from making repayments of a line of credit, including a credit card, in accordance with its normal course of business usage for such line of credit. For lines of credit with the Main Street lender, the prior guidance indicated that such repayments could be accepted only if they were "regularly scheduled, periodic" payments, which created some uncertainty as to the scope of permissible repayments to the lender.

The updated guidance has revised the language to omit the use of the phrase "regularly scheduled, periodic" and, accordingly, Main Street lenders will now be subject to the same line of credit repayment constraints as third party creditors – i.e., a borrower may repay the line of credit in accordance with its normal course of business usage for such line.

FEES ASSOCIATED WITH THE LOAN FACILITIES

Additional Fees That Lenders May Charge Borrowers

The existing terms of the Program permitted a lender to charge a borrower a one-time origination fee and to require the borrower to pay the facility transaction fee which the SPV charged to the lender, but was silent as to whether any other fees could be charged to a borrower.

The new guidance clarifies that the only additional fees that lenders are permitted to charge borrowers under the Program are de minimis fees for services that are customary and necessary in the lender's underwriting of commercial loans to similar borrowers, such as appraisal and legal fees. This prevents, among other things, the charging of servicing fees to borrowers.

LOAN PARTICIPATIONS

The prior guidance for the Program did not provide any details as to the loan participation agreement or the rights of the SPV and the Main Street lender thereunder. The forms of Loan Participation Agreement and Co-Lender Agreement have now been provided, and certain details have been clarified through updates to the FAQs.

The Loan Participation Agreement is the agreement under which the SPV purchases its 85% or 95% (as applicable) participation in a Main Street loan from the lender. The Co-Lender Agreement only becomes effective if and when the SPV decides to "elevate" its participation interest to an actual assignment, as discussed below.

Note that each of the Loan Participation Agreement and the Co-Lender Agreement is structured as a short "Transaction Specific Terms" document, which includes the specific details as to the Main Street loan and the parties, and a "Standard Terms and Conditions" document, which contains the legal terms and conditions and is incorporated by reference into the Transaction Specific Terms. Although the Transaction Specific Terms portion of the agreement overrides the Standard Terms and Conditions, it only contemplates that limited categories of information would be filled in and, presumably, substantive modifications would not be permitted.

Sale by SPV of its Participation Interests

The SPV may transfer its loan participation (without elevating) at any time to certain authorized governmental assignees, although such transfers cannot be undertaken to effect a securitization, or upon any event which allows the SPV to elevate its participation to an assignment (as discussed below). Otherwise, the SPV may transfer its loan participation (without elevating) only with the contemporaneous consent of the lender.

Elevation by SPV of its Participation Interests

The SPV is generally permitted to elevate its participation into an assignment in privity with the borrower as follows:

a. at the option of the SPV, if the borrower has defaulted on the payment of a Main Street loan and the applicable grace period has elapsed;

b. at the option of the SPV, if the borrower or the lender has become the subject of bankruptcy or other insolvency proceedings;

c. automatically, if the lender would take, or refrain from taking, an action that would result in impermissible forgiveness (under section 4003(d)(3) of the CARES Act) of principal of the portion of the Main Street loan beneficially owned by the SPV;

d. if required to do so by a statute or court; or

e. with the contemporaneous consent of the borrower and the lender and, in the case of a MSELF upsize, any other necessary parties to the underlying loan (i.e., the administrative agent in a multi-lender facility)

The new guidance explains that, although the SPV will have the option to elevate its participation to an assignment in the circumstances described in clauses a. and b. above, the Federal Reserve does not expect the SPV to use this right as a matter of course. Rather, lenders would be expected to follow market-standard workout processes and to exercise the standard of care set out in the Loan Participation Agreement (i.e., to exercise the same duty of care in approaching such proceedings as it would exercise if it retained a beneficial interest in the entire loan). In general, the Federal Reserve expects that the SPV generally would not expect to elevate except in situations where (i) the economic interests of the lender and the SPV are misaligned, or (ii) the loan amount is relatively large in comparison to other loans in the SPV's portfolio of participations.

SPV Approach to Decision-Making with respect to its Voting Rights

The new guidance advises that the SPV will make commercially reasonable decisions to protect taxpayers from losses on Main Street loans and will not be influenced by non-economic factors when exercising its voting rights under the Loan Participation Agreement or the Co-Lender Agreement, including with respect to a borrower that is the subject of a workout or restructuring.

Special Administrative Priority Under Section 507(a)(2) of the Bankruptcy Code

Under each of the Loan Participation Agreement and the Co-Lender Agreement, the SPV will waive and disclaim its special administrative priority right under Section 507(a)(2) of the Bankruptcy Code for its claims against a Main Street borrower in bankruptcy proceedings.

> ***Observation:*** *This waiver was likely necessary to induce lenders to use the Program as, absent such waiver, the lender's 5% or 15% retained interest (and any other credit previously extended to the borrower) would effectively be subordinated to the SPV's participation.*

Required Retention by Lender of its Participation Interest

The new guidance also clarifies that the SPV's assignment of its participation interest to a "governmental assignee" will not release a lender from its obligation to retain its 5% or 15% (as applicable) participation interest in a Main Street loan or, in the case of the Expanded Facility, the lender's interest in either of the upsized loan tranche or the underlying loan.

Other Terms of Participation Agreement

In addition to the elevation provisions and waiver of special administrative priority mentioned above, the Participation Agreement contains several other provisions of note:

Voting Rights.

As stated above, the Participation Agreement provides that, prior to elevation of the SPV's interest in the Main Street loan to an assignment, the originating lender shall retain the authority to administer the loan and exercise voting rights under the loan documents, except where such actions (or inactions) would constitute "Core Rights". Core Rights include:

- extension, increase or reinstatement of any commitment relating to such loans;
- reduction in the principal, the rate of interest or any fees or other amounts payable with respect to such loans;
- any delay or postponement of any scheduled payment, or any reduction in the amount of or waiver of such payment;
- any change of the pro rata sharing provisions;
- any release of all or substantially all of the collateral or substantially all of the value of the guarantees;
- the waiver of any condition precedent to closing, effectiveness or funding;
- any waiver of or consent to departure from the certifications of the borrower under the CARES Act or the Federal Reserve Act;
- any waiver of or consent to departure from the borrower's financial reporting requirements;
- any express subordination of the loans or the collateral securing them;
- any amendment that imposes restrictions on the SPV's ability to assign, participate or pledge its interest in the loans;
- any action that would have a disproportionately adverse effect on the participated loans;
- any amendment that would affect, or any waiver of, the provision that makes the acceleration of any other debt owed by the borrower to the lender or any of its affiliates a default (a "Seller Debt Cross-Acceleration");
- the acceleration, or failure to accelerate, the loans following a Seller Debt Cross-Acceleration;

- the exercise, or failure to exercise, remedies with respect to shared collateral following a Seller Debt Cross-Acceleration; and

- any change to any lender voting approval level.

> ***Observation**: Among the Core Rights are several categorical provisions (including waivers of borrower reporting requirements and departures from required borrower certifications) which will frustrate the purported latitude afforded the originating/servicing lender and cause said lender to err on the side of caution in administering these loans.*

Transferability

The SPV may assign its participation interest or sell subparticipations to any Federal Reserve Bank, any vehicle established by the Fed, any entity created by an act of Congress, any department or agency of the federal government, or as required by any statute or court, all without the need for consent from the originating lender.

The SPV may also assign its participation interest or sell subparticipations without the need for consent from the originating lender following a payment default by the borrower or any other obligor, the insolvency of the borrower, the insolvency of the originating lender or any reduction in the principal amount of the participated loan in violation of Section 4003(d)(3) of the CARES Act.

Any other assignment by the SPV requires the consent of the originating lender (which may not be unreasonably withheld or delayed).

The originating lender may not assign its interest under the Participation Agreement without the prior consent of the SPV.

Indemnification.

The lender agrees to indemnify the SPV and certain other beneficiaries for any losses arising out of a breach of any of Seller's representations, warranties, covenants or agreements in the Participation Agreement.

Governing Law and Submission to Jurisdiction.

Although the program is administered by the Federal Reserve Bank of Boston, the Participation Agreement is governed by New York law and the parties submit to jurisdiction in New York.

Other Terms of Co-Lender Agreement

The main purpose of the Co-Lender Agreement is to convert any bilateral transaction in which the SPV has purchased a participation interest into a syndicated credit facility following elevation by the SPV of its participation interest into an assignment of its pro rata share of the loan. Pursuant to the Co-Lender Agreement, the SPV or its assignee appoints the originating lender as the administrative agent under the underlying credit agreement.

As in any syndicated credit facility, most decisions (including loan acceleration, exercise of remedies, amendments and waivers) are made by the administrative agent with the consent or pursuant to the instructions of the requisite majority lenders (that is, lenders that hold more than 50% of the credit exposure). A few "sacred rights" (such as payment forgiveness, interest rate reductions and payment deferrals) require the consent of all the lenders, or at least all affected lenders. That is the approach taken in the Co-Lending Agreement.

> ***Observation**: Since the SPV's interest in any bilateral transaction will start out at 85% or 95% of the underlying loan, unless it significantly reduces its interest through assignments it will control all decisions under the Main Street loan documents.*

ADDITIONAL MATTERS FOR LENDERS

Loan Documents

Previous guidance had indicated that participating lenders should use their own loan documentation for the Program. The new guidance states that such documentation should be substantially similar, including with respect to required covenants, to the loan documentation that the lender uses in its ordinary course lending to similarly situated borrowers, adjusted only as appropriate to reflect the requirements of the Program.

The new guidance includes a checklist of items that must be reflected in the Main Street loan documents (see the Loan Documents Checklist table attached as Appendix A to the updated FAQ). The checklist includes certain new requirements which must be included in the loan documents, as follows:

Provision That Must Be Included (All Program Options)	**Variations for MSELF Facility**
Borrower Certifications and Covenants material breach mandatory prepayment provision.	Such provision must be included only to the extent feasible in light of existing voting arrangements.
Cross acceleration provision for other debt owed to the lender or any of its affiliates.	If the underlying loan is a multi-lender facility, any cross-default or cross-acceleration provision that was negotiated in good faith prior to April 24, 2020 as part of the underlying loan shall be sufficient.
Lien covenant/negative pledge provision (see "FEATURES OF ELIGIBLE LOANS – Priority Requirements – Lien Covenants" above).	If the underlying loan is a multi-lender facility, any lien covenant that was negotiated in good faith prior to April 24, 2020 as part of the underlying loan shall be sufficient.
Financial reporting covenant provision, requiring the borrower to provide the financial information set out in Appendix C to the updated FAQs.	If the underlying loan is a multi-lender facility, any financial reporting provision that was negotiated in good faith prior to April 24, 2020 as part of the underlying loan shall be sufficient.

Certain model covenants that lenders may elect (but are not required) to use when drafting their loan documents in order to satisfy these requirements are included as Appendix B to the updated FAQ. The Appendix B also includes model priority and security covenants.

Observations:

(1) *The financial reporting requirements under Appendix C to the updated FAQs are significantly more extensive than lenders typically require in loan documents.*

(2) *Appendix A and Appendix B to the updated FAQs both reference only quarterly financial reporting. However, Appendix C to the updated FAQs includes separate tables for "data required quarterly" and "data required annually". Presumably, this was just an oversight and the financial reporting covenant must also require reporting of the data required annually.*

Servicing Agreement

As stated above, the Servicing Agreement allows the originating lender to administer and enforce the Main Street loan in accordance with the Participation Agreement, subject to the same standard of care said lender would use for loans originated for its own account. The Servicing Agreement also specifies the originating lender's role in collection of certain program specific borrower financial information. The Servicing Agreement also limits the originating lender's liability and responsibility for the contents of said information, absent said lender's gross negligence, fraud, willful misconduct or material breach.

Lender Accounting for the Transfer of Participation Interest to the SPV

The new guidance indicates that the Program's structure is intended and expected to meet the accounting rules necessary for the loan participations sold to the SPV to qualify for sale treatment and thus removal from the lender's financial statements, although lender consideration of the specific facts is still necessary to support sale treatment. In addition, MSELF loan upsizes will need to be evaluated further to support that the upsized tranche is a separate and distinct unit of account to qualify for sale treatment, and the guidance enumerates certain factors that a lender should consider in such an evaluation.

Loan Funding

The new guidance indicates that the lender may elect for the Main Street loan funding to occur prior to submission to the SPV of the paperwork for the loan participation sale to the SPV (a "Funded Loan") or to be contingent upon the lender entering into a binding commitment with the SPV to purchase a participation in the loan from the lender (a "Conditioned Loan"). Under either of these options, a loan participation sale to the SPV requires that the lender first register with the Program and then submit all of the required documentation, completed and signed, for processing.

<u>Funded Loans</u>

Funded Loans must be submitted to the SPV for sale of a participation interest expeditiously (i.e., no later than 14 days) after the loan closing. Upon determining that such paperwork is complete and consistent with Program requirements, the SPV would purchase a participation in such Funded Loan by dating and countersigning the Participation Agreement and returning it to the lender.

<u>Conditioned Loans</u>

For Conditioned Loans, upon determining that such paperwork is complete and consistent with Program requirements, the SPV would provide the lender with a binding commitment to purchase the loan after it is funded (a "<u>Commitment Letter</u>"). The Commitment Letter will indicate that the lender is required to fund the Conditioned Loan within three business days of the date of the Commitment Letter and that the SPV will purchase the participation in the Conditioned Loan not later than three business days after the lender notifies the SPV that the lender has funded the Conditioned Loan. The lender will provide this notification by entering the funding date of the Conditioned Loan into a field in the Main Street Portal.

The SPV will then process its purchase of a participation in such Conditioned Loan on the basis of the previously received paperwork, which need not be re-submitted. The loan documents for Conditioned Loans should include language making funding contingent upon receipt of the SPV Commitment Letter. Sample language is set forth in Appendix B to the updated FAQs.

Observations:

(1) The guidance does not specify how long the SPV will take to process the paperwork and purchase its participation in Funded Loans, or to process the paperwork and issue its Commitment letter for Conditioned Loans.

(2) Even under the Conditioned Loan approach, the originating lender must initially fund the loan and wait up to three business days for reimbursement from the SPV. The need for short term cash outlays may pose challenges for lenders.

The terms of the Loan Facilities are subject to further rulemaking and guidance from the Federal Reserve System and the Federal Reserve Bank of Boston. We will continue to monitor developments and provide additional details as they become available. In the meantime, please feel free to contact us if you have any questions about the Program.

CONTACT

Please do not hesitate to contact your Windels Marx relationship lawyer or a member of our <u>Financial Transactions Practice Group</u> with any questions or comments.

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