WINDELS MARX | Windels Marx Lane & Mittendorf, LLP

CLIENT MEMORANDUM

COVID-19 – The CARES Act: The Main Street Lending Program

April 16, 2020 by Michael J. Clain

The Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), signed into law on March 27, 2020, established multiple financial assistance programs to support businesses and governmental entities affected by the COVID-19 pandemic. These programs take several forms, including direct lending through eligible institutions, credit support, providing liquidity to the capital markets and other investments.

The first direct loan program, the Paycheck Protection Program ("PPP"), which authorizes up to $349 billion in forgivable loans to small businesses and non-profits was launched on April 3rd. That program is aimed at organizations with 500 or fewer employees and, as the name suggests, it is intended primarily to help borrowers pay their employees during the COVID-19 crisis. Information about the program is available on our COVID-19 page.

On April 9th the Board of Governors of the Federal Reserve System (the "Board") issued interim guidance regarding its second direct loan program, the Main Street Lending Program. The program authorizes Federal Reserve Banks to purchase participations of up to $600 billion in eligible loans to companies employing up to 10,000 workers or with revenues of less than $2.5 billion. The program hasn't been finalized yet – the comment period ends on April 16th – but the interim guidance provides sufficient detail to start considering how to best engage with it. We expect that additional information, including procedures for applications, will be made available shortly after the comment period ends.

Overview: The Main Street Lending Program consists of two separate facilities: the Main Street New Loan Facility (the "New Loan Facility") and the Main Street Expanded Loan Facility (the "Expanded Loan Facility"). Under the New Loan Facility a Federal Reserve Bank will commit to lend to a special purpose vehicle (an "SPV"), which will purchase 95% participations in new eligible loans. Under the Expanded Loan Facility the SPV will purchase 95% participations in the upsized tranche of existing eligible loans (we'll refer to loans in which an SPV has purchased a participation under the New Loan Facility or the Expanded Loan Facility (collectively, the "Loan Facilities") as "Main Street Loans"). The combined size of the Loan Facilities is $600 billion. We've seen no indication of their relative size.

Eligible Lenders: Only U.S. insured depository institutions, U.S. bank holding companies and U.S. savings and loan holding companies are eligible to participate in the Loan Facilities.

> ***Observation**: U.S. branches and agencies of foreign institutions and nonbank lenders appear to be ineligible. Based on positions taken by the Board in the past, it is likely that*

nonbank lenders that are affiliated with U.S. insured depository institutions will be permitted to participate in the program. There is no indication that foreign ownership of a U.S. insured depository institution would disqualify it from participating in either Loan Facility.

Eligible Borrowers: Any business that (a) has up to 10,000 employees or up to $2.5 billion in 2019 annual revenues, (b) is created or organized in the United States or under the laws of the United States and (c) has significant operations in and a majority of its employees based in the United States is eligible to participate in either Loan Facility. Businesses may not participate in both Loan Facilities, and businesses that participate in either Loan Facility may not also participate in the Primary Market Corporate Credit Facility (a separate program under the CARES Act that provides a funding backstop for corporate debt of certain investment grade companies). However, businesses that have taken advantage of the PPP may also take out Main Street Loans.

Observations: *1. The guidance released by the Board doesn't address affiliation rules for purposes of determining workforce or revenue limits.*

2. U.S. subsidiaries of foreign entities may be eligible to participate in the Loan Facilities as long as they meet the "significant operations" and "majority of employees" tests (neither of which is defined in the CARES Act or the guidance issued by the Board to date).

3. The CARES Act requires that the Board establish procedures to prohibit borrowing under the program by borrowers that are insolvent. Although current guidance does not contain any such procedures, we expect that the final rules will require officer certification of solvency and will prohibit participation in the program by entities that are in bankruptcy.

Features of Eligible Loans:

Feature	New Loan Facility	Expanded Loan Facility
Origination Date	On or after April 8, 2020	Upsizing on or after April 8, 2020 of a loan made by an Eligible Lender to an Eligible Borrower before April 8, 2020
Maturity	4 years	4 years
Amortization	Principal and interest payments deferred for one year	Principal and interest payments deferred for one year
Interest Rate	Secured Overnight Financing Rate ("SOFR") + 250-400 basis points	SOFR + 250-400 basis points
Security	Must be unsecured	May be secured or unsecured
Minimum loan size	$1 million	$1 million

Feature	New Loan Facility	Expanded Loan Facility
Maximum loan size	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 4 times the borrower's 2019 EBITDA	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 6 times the borrower's 2019 EBITDA
Prepayments	Permitted without penalty	Permitted without penalty

***Observations**: 1. Revolving credit loans do not appear to be eligible under either Loan Facility*

2. SOFR is currently .01%, so the initial interest rate on Main Street Loans will be in the 2.5-4.00% range

3. There have been very few SOFR-indexed bank loans, and those have been limited to the large corporate market. The Board is using this program to accelerate the move from LIBOR to SOFR in the middle market but doing so may require significant retraining of bank personnel and retooling of back office operations. Large financial institutions that are familiar with SOFR from the corporate market may have a significant advantage over smaller institutions.

4. Leverage ratios are tighter for the New Loan Facility than for the Expanded Loan Facility. Given the problem this program is meant to address we could see a loosening of credit limits in the New Loan Facility.

Loan Participations: The SPV will purchase at par a 95% participation in (a) each Eligible Loan made under the New Loan Facility and (b) the upsized tranche of each Eligible Loan made under the Expanded Loan Facility. Each loan participation will be pari passu with the lender's retained interest in the loan and will be secured by any collateral securing the loan on a pro rata basis.

***Observation**: The Board's guidance does not address the SPV's rights or the lender's obligations under the participation agreement, such as voting, reporting, etc.*

Required Representations and Covenants:

- The lender cannot cancel or reduce, or use a Main Street Loan to replace, any of its existing lines of credit to the borrower.

- The borrower must agree that:

- It will not use the proceeds of any Main Street Loan to repay other loan balances (whether owed to the lender of the Main Street Loan or any other entity);

***Observation**: This would prevent any entity that wants to take advantage of the program from switching lenders, severely limiting the universe of potential transactions.*

- It will not make any voluntary prepayments on any other debt of equal or lower priority before repaying the Main Street Loan in full;
- It will not seek to cancel or reduce any of its outstanding lines of credit;
- It requires the financing due to the exigent circumstances presented by the COVID-19 pandemic
- It will make reasonable efforts to maintain its payroll and retain its employees during the term of the loan;
- It meets the leverage test specified above;
- As long as the loan is outstanding and for 12 months thereafter, it will not repurchase any equity security of the borrower or any parent company that is listed on a national securities exchange while the loan is outstanding, except to the extent required under a contractual obligation that was in effect on March 27, 2020;

***Observation**: The CARES Act prevents only the repurchase of listed securities, so this restriction will likely not be a material factor in deciding whether a U.S. subsidiary of a foreign company should apply for a Main Street Loan. However, the restriction on capital distributions below may, as a practical matter, prohibit the repurchase of unlisted securities.*

- As long as the loan is outstanding and for 12 months thereafter, it will not pay dividends or make other capital distributions with respect to its common stock;

***Observations**: 1. Although the restriction on capital distributions applies only to common stock, it is reasonable to assume that the Board intended it to apply to preferred stock, membership interests and other forms of equity, as well as to redemptions of privately held equity.*

2. The restriction on dividends and distributions would prohibit tax distributions for pass-through entities.

- As long as the loan is outstanding, it will limit total compensation paid to its officers and other highly paid employees in accordance with the CARES Act.

***Observation**: There are two sets of limitations, which are set forth in Section 4004 of the CARES Act; one set applies to officers or employees whose total compensation exceeded $425,000 in 2019 (other than employees whose compensation was determined through a collective bargaining agreement) and another to officers or employees whose total compensation exceeded $3,000,000 in 2019.*

SPV Facility Fee: Under the New Loan Facility, the SPV will be entitled to a 1% facility fee on the principal amount of its participation, payable by the lender or, at the lender's option, the borrower. The SPV will not be entitled to a facility fee with respect to its participation in the upsized tranche of any loan purchased by it under the Expanded Loan Facility.

Lender Origination Fee: The borrower will pay the lender a 1% origination fee on each new Main Street Loan under the New Loan Facility and the upsized tranche of each Main Street Loan under the Expanded Loan Facility.

Servicing Fee: The originating lender will service its Main Street Loans and the SPV will pay the lender 25 basis points on the principal amount of its participation for loan servicing.

Facility Termination: The SPV will cease purchasing participations in Eligible Loans on September 30, 2020, unless the Board and the Treasury Department extend the Loan Facilities.

It is likely that a number of restrictions will be eliminated in response to comments from the financial community. 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 this program or any comments that you would like us to forward to the Board.