

The Federal Reserve Launches \$600 Billion Main Street Loan Programs: Loans to Small- and Medium-Sized Businesses

David E. Frulla, Timothy R. Lavender

April 15, 2020

On Thursday, April 9, 2020, the Federal Reserve (the Fed) announced two Main Street Lending Facilities, one for new loans (Main Street New Loan Facility) and the second for expanded loans (Main Street Expanded Loan Facility), as part of a suite of funding measures designed to support the economy. Combined, the total Main Street loan facility – authorized under Section 13(3) of the Federal Reserve Act – will enable up to \$600 billion in new financing for small- and medium-sized businesses. In all, the facilities the Fed announced last Thursday can inject up to \$2.3 trillion into the COVID-19 battered economy. The Fed has kept some of its powder dry, however, reserving Treasury capital for approximately \$2 trillion in additional leverage.

In creating the Main Street Lending Program, the Fed elected the more flexible option of the two it had available under the recently-enacted Coronavirus Aid, Relief, Economic Security Act (CARES Act) to provide support for small and mid-sized businesses – those with under 10,000 employees and \$2.5 billion in annual revenue. The Main Street Lending facilities were implemented pursuant to Title IV of the CARES Act. This is distinct from the CARES Act Title I Paycheck Protection Program (PPP) for small businesses, certain small non-profit organizations, and the self-employed.

How Will The Main Street Lending Program Be Funded?

The Fed plans to lend funds on a recourse basis to a single special purchase vehicle (SPV) that will be capitalized by \$75 billion of equity capital from the Treasury. The SPV will use the proceeds of the Treasury equity investment and loans made from the Fed to purchase up to \$600 billion of eligible loans.

The loans made by the Fed to the SPV will be secured by the portfolio of present and future eligible loans held by the SPV. Notably, however, and in contrast to the Fed's liquidity program for the purchase of loans under the Paycheck Protection Program, the Fed will only purchase 95% of the aggregate principal amount of loans made by eligible lenders, requiring eligible lenders to retain 5% of the risk of the loan on their own balance sheet.

Who Are Eligible Lenders?

Eligible lenders for the Main Street facilities include U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies. Generally, a mid-sized business should be able to reach out to the bank at which it has a pre-existing lending relationship regarding a Main Street loan.

Under the PPP, by contrast, eligible lenders were originally Small Business Administration Section 7(a) lenders, and other banking institutions could apply to join the program. While most, if not all, banks of note are joining the PPP lending program, there was some confusion at the outset, given the PPP loans' unorthodox nature.

Who Are Eligible Borrowers?

Eligible borrowers include businesses created or organized in the United States, with up to 10,000 employees or up to \$2.5 billion in 2019 annual revenues, and with "significant operations" and a majority of employees based in the United States. Eligible borrowers must also be financially sound.

What Are a Main Street Loan's Principal Terms?

A Main Street loan has the following principal attributes:

- 4-year maturity
- Amortization of principal and interest deferred for one year
- Adjustable rate of the SOFR (secured overnight finance rate) + 2.5-4.0%
- Minimum loan size of \$1 million
- Maximum loan size of the Main Street New Loan Facility is the lesser of (i) \$25 million, or (ii) amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed four times the borrower's 2019 earnings before interest, taxes, depreciation, and amortization (EBITDA)
- Maximum loan size of the Main Street Expanded Loan Facility is the lesser of (i) \$150 million, or (ii) 30% of the eligible borrowers existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added, to the eligible borrowers existing outstanding and committed but undrawn debt does not exceed 6 times 2019 EBITDA.
- Prepayment without penalty

How Does the Main Street Lending Program Fit into the Federal COVID-19 Relief Efforts?

The much-anticipated Main Street Lending Program fills an important gap in the Treasury Department's relief program to U.S. businesses. Launched a week prior to the Main Street Lending Facilities, the Paycheck Protection Program is limited to small businesses and non-profits (those entities, when combined with their "affiliates," have less than the greater of 500 employees or the Small Business Administration size standard for their industry classification), and the self-employed. The \$349 billion PPP has proven enormously popular and is projected to run short of loans long before its June 30, 2020 sunset. In fact, within days of its debut, Congress is already discussing if and how to add hundreds of billions more to the PPP.

What Business and Operational Commitments do Main Street Borrowers Need to Make?

Like the PPP program, Main Street Lending Program participants will be required to execute a series of representations and certifications established by the Federal government. In large part, these

attestations are designed to ensure prompt repayment of the Main Street loans and to not disadvantage lenders that choose to participate in the program:

- The borrower must agree not to use loan proceeds to repay other loan balances as well as other debt of equal or lower priority, with the exception of mandatory principal payments, until after the borrower has repaid the Main Street loan in full;
- The borrower must represent that it will not seek to cancel or reduce any of its outstanding lines of credit with the Main Street lender or any other lender;
- The borrower must attest that it requires the financing due to exigent circumstances caused by the COVID-19 pandemic and that “using the proceeds of the Eligible Loan, it will make reasonable efforts to maintain its payroll and retain its employees during the term of the Eligible Loan;”
- The borrower must certify that it meets the EBITDA leverage limit described above;
- The borrower must certify that it will follow certain compensation, stock repurchase and capital distribution restrictions contained in the CARES Act, namely not to repurchase publicly traded securities until the date 12 months after the loan is repaid, except as required by a pre-existing contract; not to pay dividends or make other capital distributions with respect to the borrower’s common stock for that same period; and to agree to compensation and severance package limits for highly compensated officers or employees; and
- Conflict of interest provisions also apply to preclude Administration officials, Members of Congress, and their families from participating in the program.

Does the Main Street Lending Program Involve Important Macro-Level Policy Choices?

While the PPP enjoyed bipartisan support from the time it was proposed, loans for larger businesses engendered more debate. Democrats in Congress were concerned that Title IV was originally drafted so broadly that loan proceeds could be used for a range of activities unrelated to emergency support for business interruption during the COVID-19 pandemic (such as stock buybacks, refinancing of existing debt, and dividends). The Main Street Lending Program includes some, but far from all, of the restrictions Democrats added during the CARES Act negotiations.

More specifically, Section 4003(c)(3)(D)(i) of the CARES Act provides that “the Secretary shall endeavor to seek the implementation of a program or facility ... that provides financing to banks and other lenders that make direct loans to eligible businesses, including, to the extent practicable, nonprofit organizations, with between 500 and 10,000 employees, with such loans being subject to an annualized interest rate that is not higher than 2 percent per annum.” The mid-sized loan program described by the CARES Act comes with a wide range of conditions the Main Street Lending Program does not contain, including among others, a requirement the borrower retain 90% of its workforce, not outsource or offshore jobs during the period of the loan and for two years after, not abrogate collective bargaining agreements, and stay neutral in union organizing efforts. In an interesting choice of statutory terminology, sub-paragraph (D)(i) requires the Treasury Department to “endeavor” to create this lending program, but does not require it. Treasury has for now held off on implementing this lending program.

In addition to the program contained in sub-paragraph (D)(i), CARES Act Title IV provides in

subparagraph (D)(ii) for the “Main Street Lending Program” under Section 13(3) of the Federal Reserve Act. Section 13(3) is the Fed’s emergency authority, which has been utilized sparingly in its nearly one-hundred year history, notably during the Great Depression and the Great Recession. More general than the mid-sized loan program, the CARES Act provides that [n]othing in this subparagraph [that is, including the mid-sized lending program] shall limit the discretion of the Board of Governors of the Federal Reserve System to establish a Main Street Lending Program or other similar program or facility that supports lending to small and mid-sized businesses on such terms and conditions as the Board may set consistent with Section 13(3) ...” Through this sub-paragraph (D)(ii) lending program, the Fed and Treasury crafted their own series of restrictions on borrowers and lenders, including certain, more-limited statutory restrictions and adding other requirements. It remains to be seen whether this approach will engender political controversy amidst the many exigencies caused by COVID-19.

The Main Street Lending Program is notable in several other respects:

1. It extends to small businesses, not just mid-sized businesses, and does not preclude pre-existing PPP borrowers, albeit PPP borrowers would not be able to borrow Main Street funds for the same purposes as a PPP loan (maintaining eight weeks of payroll, and certain mortgage interest and utility costs).
2. It is not limited to the small businesses to which the PPP applies, either via the SBA’s Standard Operating Procedures for its lending programs (for instance, generally precluding loans to passive investment entities) or the affiliation rules, described briefly above.
3. The Main Street Lending Program contains a variable interest rate (2.5-4.0% above SOFR, the secured overnight financing rate), rather than a 2% rate. The variable rate structure may make the lending program more attractive to banks than a 2% flat rate contained in the subparagraph (D)(i) program or the 1% flat rate contained in the PPP.

Kelley Drye has been closely monitoring the federal government response to the COVID-19 pandemic. Our goal is to help clients face current challenges and address questions that impact business operations as information becomes available to us. We have been providing up-to-date information including daily advisories, blog posts and frequent webinars about the legal and business implications related to the pandemic, all of which can be found on the firm’s [COVID-19 Resource Center](#).