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Federal Reserve Announces Main Street Lending Program and Other Facilities to Provide Credit to Businesses, States, and Municipalities Impacted by COVID-19

April 9, 2020

Financial Services

Today, the Board of Governors of the Federal Reserve announced the creation of four new liquidity facilities and the expansion of three previously announced liquidity facilities to provide credit to borrowers impacted by the COVID-19 pandemic. Whereas the previously announced programs primarily targeted certain financial markets and their participants (such as the markets for commercial paper and U.S. Treasury securities), the new programs announced today will be used to support loans to U.S. businesses, as well as certain U.S. states and municipalities.

Today's announcement comes almost two weeks after the passage of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or the "Act"), through which Congress sought to mitigate the impacts of COVID-19 on the U.S. economy. The CARES Act appropriated $454 billion to the Treasury Department to support Federal Reserve loan facilities that will provide liquidity to eligible businesses, states, and municipalities.

Importantly, today's announcements on new facilities are preliminary and subject to change. The Federal Reserve is soliciting informal public comments regarding its programs, especially the Main Street facilities and the Municipal Liquidity Facility, via a feedback form that will be available until April 16, 2020. This suggests that the Federal Reserve is likely to further refine and adjust the terms of the facilities as it receives feedback and information from stakeholders.

The Main Street Lending Program (Two New Facilities)

Overview. The Treasury Department will make a $75 billion capital investment into a special purpose vehicle that will be used to support two closely related lending facilities that together may purchase up to $600 billion of participations in eligible loans made by eligible lenders to eligible borrowers (each as defined below). The first facility, the Main Street New Loan Facility, will purchase 95 percent participations in qualifying *new* loans originated on or after April 8, 2020. The second facility, the Main Street Expanded Loan Facility, will purchase 95 percent participations in *existing, outstanding* loans – specifically, the upsized tranche of qualifying loan increases that are granted on or after April 8, 2020. Both facilities will cease purchasing participations on September 30, 2020, unless the programs are extended by the Federal Reserve and the Treasury Department.

Eligible Lenders. For both Main Street facilities, eligible lenders are U.S. insured depository institutions and U.S. bank holding companies and savings and loan holding companies. Eligible lenders will retain a 5 percent participation in any eligible loan a participation in which is sold to either facility. Eligible lenders will receive an origination fee in an amount equal to 100 basis points of the eligible loan principal amount from the eligible borrower, and annual servicing fees in an amount equal to 25 basis points of the eligible loan principal amount from the facility. In addition, in the case of the Main Street New Loan Facility, eligible lenders will pay a facility fee in the amount of 100 basis points of the eligible loan principal amount that is purchased by the SPV. An eligible lender may require the eligible borrower to pay this facility fee.

Eligible Borrowers. For both facilities, eligible borrowers must be businesses organized in the United States with significant operations in and a majority of employees based in the United States. Eligible borrowers must have *either* not more than 10,000 employees *or* not more than $2.5 billion in 2019 annual revenues. Significantly, eligible borrowers that have taken advantage of the Paycheck Protection Program (described below) may still participate, but may not participate in the Federal Reserve's previously announced Primary Market Corporate Credit Facility (which purchases qualifying bonds as sole investor, or purchases portions of syndicated loans or bonds at issuance from investment-grade U.S. corporate debt issuers). Additionally, eligible borrowers may participate under one of the Main Street New Loan Facility or the Main Street Expanded Loan Facility, but not both.

Eligible Loans. Eligible loans under both facilities will have similar, but not identical terms. In both cases, eligible loans will be term loans of four years, which may be prepaid without penalty. Eligible loans will have an adjustable interest rate equal to the Secured Overnight Financing Rate ("SOFR") plus 250 to 400 basis points, but amortization of principal and interest will be deferred for one year. The minimum loan amount under either facility must be at least $1 million, but the maximum loan amounts differ:

- Under the Main Street New Loan Facility, the maximum loan amount is the lesser of (i) $25 million or (ii) an amount that, when added to the eligible borrower's existing outstanding and committed but undrawn debt, does not exceed four times the eligible borrower's 2019 EBITDA.
- Under the Main Street Expanded Loan Facility, the maximum loan amount is the lesser of (i) $150 million, (ii) 30 percent of the eligible borrower's existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added to the eligible borrower's existing outstanding and committed but undrawn debt, does not exceed six times the eligible borrower's 2019 EBITDA.

Finally, eligible loans under the Main Street New Loan Facility will be unsecured. Eligible loans under the Main Street Expanded Loan Facility may or may not be secured, depending on the security terms of the existing loan and/or the upsized tranche.

Attestations and Loan Conditions. Eligible lenders and eligible borrowers must make numerous attestations to participate in either facility.

An eligible lender must attest that it:

1. Will not use eligible loan proceeds to repay or refinance existing loans or lines of credit made by the eligible lender to the eligible borrower (including, in the case of the Main Street Expanded Loan Facility, the pre-existing portion of the eligible loan); and

2. Will not cancel or reduce any existing lines of credit to the eligible borrower, and the eligible borrower may not seek such cancellation or reduction.

An eligible borrower must attest that it:

1. Will not use the eligible loan proceeds to repay other loan balances, and will refrain from repaying other debt of equal or lower priority (with the exception of mandatory principal payments) until the eligible loan has been repaid in full;
2. Will not seek the cancellation or reduction of any existing lines of credit with the eligible lender or any other lender;
3. Requires the financing due to the exigent circumstances presented by COVID-19;
4. Will use the proceeds of the loan or upsized tranche to make “reasonable efforts” to maintain its payroll and retain its employees;
5. Meets the EBITDA leverage conditions described above; and
6. Will follow conditions imposed on “direct loans” under section 4003(c)(3)(A)(ii) of the CARES Act for the life of the loan plus 12 months, including restrictions on employee compensation, share repurchases, and dividends and capital distributions.

Finally, both the eligible borrower and eligible lender must also certify that the eligible borrower is eligible to participate in the facility, including in light of section 4019 of the CARES Act, which prohibits participation by “covered entities” that are controlled by the President, Vice President, a Member of Congress, or a related individual.

Paycheck Protection Program Lending Facility (New Facility)

Overview. The CARES Act also established a new Payroll Protection Program (“PPP”) under section 7(a) of the Small Business Act to provide small businesses with forgivable, low-interest, non-recourse loans to be used for traditional section 7(a) purposes, as well as special designated purposes such as payroll, health care, and rent. PPP loans are fully guaranteed by the Small Business Administration (“SBA”) and forgivable if they are used for these purposes during the eight-week period after the date the loan proceeds are disbursed and the borrower has maintained or re-hired recently laid off employees by June 30, 2020. The CARES Act appropriated $349 billion toward the PPP and other section 7(a) lending through June 30, 2020, and Congress is currently considering an additional round of funding.

To encourage lenders to participate in the PPP, the Federal Reserve today announced the creation of a Paycheck Protection Program Liquidity Facility (the “PPPLF”) that will provide liquidity to PPP lenders through term financing backed by the PPP loans, which the Federal Reserve will take as collateral at face value.

Loan Terms. The Federal Reserve will extend credit to PPP lenders on a non-recourse basis and at a rate of 35 basis points. The maturity date of the credit extension matches that of the underlying PPP loan pledged as collateral, including that the maturity date will be accelerated if (i) the PPP loan goes into default and is sold to the SBA or (ii) the PPP loan is forgiven.

Eligible Borrowers. All depository institutions that originate PPP loans are eligible to participate. The term sheet also notes that the Federal Reserve "is working to expand eligibility to other lenders that originate PPP [loans] in the near future." (In this regard, the Treasury Department, in consultation with other regulators, has recently established a process by which non-bank lenders and non-insured depository institutions may apply to become PPP lenders.)

Regulatory Capital Treatment. PPP loans are assigned a zero-percent risk weight for regulatory capital purposes, but no leverage ratio relief is provided by statute. The PPPLF term sheet notes that, also on April 9, 2020, the Federal Reserve, the OCC, and the FDIC issued an interim final rule to encourage banks to participate in the PPPLF by allowing banking organizations to neutralize the effect of PPP loans financed under the PPPLF on leverage capital ratios. Consistent with the treatment that the agencies previously provided to banking organizations to facilitate use of the Federal Reserve's Money Market Mutual Fund Liquidity Facility, this interim final rule allows a bank to exclude any loan originated pursuant to the PPP and pledged to the PPPLF from its standardized total risk-weighted assets, average total consolidated assets, advanced approaches total risk-weighted assets, and total leverage exposure, as applicable. The interim final rule notes that it is appropriate to provide this regulatory capital relief with respect to PPP loans pledged as collateral through the PPPLF, because the Federal Reserve's extension of credit is non-recourse to the lender and therefore the lender is not exposed to credit or market risk.

Municipal Liquidity Facility (New Facility)

Overview. The Treasury Department will make a $35 billion capital investment in the Municipal Liquidity Facility (the "MLF"), which will help state and local governments manage their cash flows by purchasing an aggregate of up to $500 billion of eligible notes from eligible issuers. The MLF will cease purchasing eligible notes on September 30, 2020, unless the program is extended by the Federal Reserve and the Treasury Department.

Eligible Issuers. All U.S. states (including the District of Columbia), U.S. counties with a population of at least 2 million residents, and U.S. cities with a population of at least 1 million residents are eligible to sell eligible notes to the facility. Additional counties and cities may receive support through state issuers. Only one issuer per state, city, or county is eligible to participate, but the facility may purchase more than one issue from an issuer.

Eligible Notes. The facility is authorized to purchase tax anticipation notes, tax and revenue anticipation notes, bond anticipation notes, and other similar notes. All notes must mature no later than 24 months after issuance. The Federal Reserve has reserved the power to review the eligibility of each note and may require legal opinions and disclosures.

Program Limitations. In addition to the $500 billion ceiling on aggregate purchases from all Eligible issuers, an individual issuer limit also applies. The MLF may purchase up to an aggregate amount of 20 percent of the general revenue from the issuing government's own sources and utility revenue for fiscal year 2017. States may ask to sell notes in excess of the limit in order to assist political subdivisions and instrumentalities that are not eligible for the MLF.

Pricing and Fees. The MLF will price the eligible notes based on an issuer's rating at the time of the purchase. The MLF will charge an origination fee equal to 10 basis points of the principal amount of the Eligible notes purchased (which origination fee may be paid from the proceeds of the issuance). The eligible issuer may call the notes purchased by the MLF at any time.

Conditions. Eligible issuers may only use the proceeds of the sale of eligible notes for three broad purposes: (i) to help manage the impact of income tax deferrals resulting from an extension of a filing deadline; (ii) to offset potential reductions of tax and other revenues or increases in expenses related to or resulting from the COVID-19 pandemic; and (iii) to satisfy requirements for the payment of principal and interest on the issuer's obligations. A state issuer may use the proceeds of its note sales to the MLF to purchase similar notes issued by, or otherwise to assist, local governments that face the same challenges.

Term Asset-Backed Securities Loan Facility (Expansion of Existing Facility)

The Federal Reserve announced on March 23, 2020 that it would re-establish the crisis-era Term Asset-Backed Securities Loan Facility ("TALF") to serve as a funding backstop to facilitate the issuance of asset-backed securities ("ABS") by making non-recourse loans to eligible borrowers with a term of three years that are fully secured by eligible ABS. Today, the Federal Reserve released an updated term sheet with the following incremental changes to the TALF:

- Eligible borrowers and issuers of eligible collateral must be U.S. companies within the meaning of the CARES Act, which requires the entities to be organized in the United States and to have significant operations in and a majority of employees based in the United States. This is a significant change from the original terms of the TALF, which imposed no "significant operations" or "majority of employees" test, and which had also expressly included a U.S. branch or agency of a foreign bank.
- The list of eligible collateral is expanded to include ABS where the underlying credit exposures are equipment leases, leveraged loans, and commercial mortgages (in connection with U.S. real property), effectively bringing certain commercial mortgage-backed securities ("CMBS") and collateralized loan obligations ("CLOs") into scope.
    - To be eligible collateral, CMBS may not be single-asset, single-borrower ABS, and must be issued prior to March 23, 2020 (*i.e.*, legacy CMBS). (All other types of eligible collateral must still be newly-issued – *i.e.*, issued after March 23, 2020.)
    - To be eligible collateral, CLOs must be static.
    - The accompanying Federal Reserve release also notes that only "triple-A rated tranches" of legacy CMBS and newly-issued CLOs have been added as eligible collateral.
- Eligible borrowers must not be "covered entities" within the meaning of section 4019 of the CARES Act (*i.e.*, the eligible borrower may not be controlled by the President, Vice President, a Member of Congress, or a related individual).
- Pricing for most categories of eligible collateral is adjusted from 100 basis points over the two-year or three-year LIBOR swap rate to 125 basis points over the two-year or three-year OIS rate, as applicable. (Different pricing applies to CLOs and certain SBA certificates.)

In addition, the updated term sheet includes a haircut schedule for purposes of collateral valuation. The haircut schedule is consistent with the haircut schedule used for the TALF established in 2008.

The most recent version of the TALF term sheet (including the haircut schedule) is available here; a comparison against the previous version (excluding the haircut schedule) is available here.

Primary Market Corporate Credit Facility (Expansion of Existing Facility)

The Federal Reserve announced on March 23, 2020 that it would establish the Primary Market Corporate Credit Facility ("PMCCF") to serve as a funding backstop for investment-grade U.S. corporate debt issuers. Today, the Federal Reserve released an updated term sheet with the following incremental changes to the PMCCF:

- The Treasury Department is expanding its initial capital investment in the PMCCF from $10 billion to $50 billion, which will increase the PMCCF's lending capacity from $100 billion to $500 billion.
- The PMCCF will no longer provide loans to eligible issuers, but will instead purchase qualifying bonds as sole investor in a bond issuance, or purchase portions of syndicated loans or bonds at issuance (up to 25 percent of the issuance).
- Eligible issuers must be U.S. companies within the meaning of the CARES Act, which requires the issuers to be organized in the United States and to have significant operations in and a majority of employees based in the United States.
- Eligible issuers "may not have received specific support pursuant to the CARES Act or any subsequent federal legislation." (No further detail is provided on this point.)
- Eligible issuers do not include insured depository institutions or their holding companies.
- Eligible issuers now must have been rated BBB-/Baa3 *as of March 22, 2020*. (This had functioned as a continuing requirement in the prior terms of the PMCCF.) Eligible issuers that are downgraded after March 22, 2020 must be rated at least BB-/BBa3 at the time of the issuance.
- Eligible issuers must not be "covered entities" within the meaning of section 4019 of the CARES Act (*i.e.*, the eligible borrower may not be controlled by the President, Vice President, a Member of Congress, or a related individual).
- The maximum amount of outstanding bonds or loans of an eligible issuer that borrows from the PMCCF may not exceed 130 percent of the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020, regardless of the issuer's rating. (The prior terms of the PMCCF has used a sliding scale of percentages, ranging from 110 percent to 140 percent, depending on ratings.)
- The PMCCF will leverage the Treasury Department's capital investment at 10 to 1 when acquiring corporate bonds or syndicated loans from investment-grade issuers, and 7 to 1 when acquiring any other eligible asset.
- Eligible issuers may approach the PMCCF to refinance outstanding debt, from the period of three months ahead of the maturity date of such outstanding debt, and may additionally approach the PMCCF at any time to issue additional debt, provided their rating is reaffirmed at BB-/Ba3 or above with the additional debt by each major ratings agency with a rating of the issuer.
- The PMCCF may not purchase more than 1.5 percent of the combined potential size of the PMCCF and SMCCF (described below) from a single issuer.

In addition, the revised PMCCF term sheet describes updated pricing information.

The most recent version of the PMCCF term sheet is available here; a comparison against the previous version is available here.

Secondary Market Corporate Credit Facility (Expansion of Existing Facility)

The Federal Reserve announced on March 23, 2020 that it would establish the Secondary Market Corporate Credit Facility ("SMCCF") to purchase eligible corporate bonds issued by eligible issuers, and eligible corporate bond portfolios in the form of exchange-traded funds ("ETFs") from eligible sellers in the secondary market. Today, the Federal Reserve released an updated term sheet with the following incremental changes to the SMCCF:

- The Treasury Department is expanding its initial capital investment in the SMCCF from $10 billion to $25 billion, which will increase the SMCCF's lending capacity from $100 billion to $250 billion.
- Among the ETFs that the SMCCF will purchase, the preponderance of ETF holdings will be ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, but the remainder will be in ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds. (Prior terms had limited ETF purchases to those whose investment objective is to provide broad exposure to the market for U.S. investment-grade corporate bonds only.)
- Eligible issuers must be U.S. companies within the meaning of the CARES Act, which requires the issuers to be organized in the United States and to have significant operations in and a majority of employees based in the United States
- Eligible issuers "may not have received specific support pursuant to the CARES Act or any subsequent federal legislation." (No further detail is provided on this point.)
- Eligible issuers do not include insured depository institutions or their holding companies.
- Eligible issuers now must have been rated BBB-/Baa3 *as of March 22, 2020*. (This had functioned as a continuing requirement in the prior terms of the PMCCF.) Eligible issuers that are downgraded after March 22, 2020 must be rated at least BB-/BBa3 at the time of the issuance.
- Eligible issuers must not be "covered entities" within the meaning of section 4019 of the CARES Act (*i.e.*, the eligible borrower may not be controlled by the President, Vice President, a Member of Congress, or a related individual).
- The SMCCF will leverage the Treasury Department's capital investment at:
  - 10 to 1 when acquiring either (i) corporate bonds from issuers that are investment-grade or (ii) ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds);
  - 7 to 1 when acquiring corporate bonds from issuers that are rated below investment grade; and
  - Between 3 to 1 and 7 to 1 when acquiring any other type of eligible asset.
- Eligible sellers must be U.S. businesses within the meaning of the CARES Act, and must satisfy the requirements of section 4019 described above. (Prior terms imposed no eligibility criteria on sellers.)

- The SMCCF may not purchase more than 1.5 percent of the combined potential size of the SMCCF and PMCCF (described above) from a single issuer.
- The maximum amount of bonds that the SMCCF will purchase form the secondary market of any eligible issuer is capped at 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020, and the SMCCF will not purchase shares of a particular ETF if after such purchase the SMCCF would hold more than 20 percent of the ETF's outstanding shares.

The most recent version of the SMCCF term sheet is available here; a comparison against the previous version is available here.

Covington & Burling LLP's Financial Services attorneys have deep experience guiding U.S. and non-U.S. financial institutions through the most challenging circumstances, including the 2008–09 financial crisis. Our team, which includes former senior federal regulators, stands ready to advise financial institutions as they navigate the impact of COVID-19 on the economy and the financial markets.

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