

Executive Summary – New Federal Reserve and Treasury Programs

After much anticipation, the Board of Governors of the Federal Reserve (Federal Reserve) on April 9, 2020 [announced](#) additional actions “using its full range of authorities” to provide US\$2.3 trillion of credit to a wide variety of business enterprises, states and municipalities. The Federal Reserve’s actions in support of existing and new programs, as described below, leverage up to US\$500 billion of investment by Treasury and leave substantial “dry powder” for the Federal Reserve to modify or provide additional financial support if and as needed after these programs take root. The guidance provided to date is both incomplete and subject to revision, with the Federal Reserve seeking public comment to its guidance on or before April 16.

Specifically, as part of its response to address the negative economic effects stemming from the COVID-19 pandemic, the Federal Reserve will:

- Purchase up to US\$600 billion in loans through the Main Street Lending Program, with the Treasury Department using US\$75 billion available under the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 (Act) to provide equity to the facility;
- Expand the size and scope of the Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF), as well as the Term Asset-Backed Securities Loan Facility (TALF), allowing these three programs to support up to US\$850 billion in credit backed by US\$85 billion in equity investments (for credit protection) provided by the Treasury Department;
- Establish a Municipal Liquidity Facility that will offer up to US\$500 billion in lending to states, as well as cities with over 1 million residents and counties with over 2 million residents, with the Treasury Department providing US\$35 billion in equity investments pursuant to the Act as credit protection for the facility; and
- Through the Paycheck Protection Program Liquidity Facility (PPPLF), supply liquidity to banks making loans to small businesses under the Paycheck Protection Program (PPP). The PPPLF will provide term financing to such banks, backed by PPP loans, taking the loans as collateral at face value with the only recourse being to the underlying PPP loans to businesses

With the exception of the PPPLF and Municipal Liquidity Facility – and subject to restrictions on size, etc. (which are discussed in detail below) – only businesses created or organized in the US or under the laws of the US, and that have significant operations in and a majority of their employees based in the US, are eligible for financial assistance under these Federal Reserve programs.

In this alert, we provide an overview of each of these programs and their respective term sheets, including as they relate to eligible assets and issuers, limits per issuer and pricing, among other issues. As we did in our previous [alert](#), we also discuss key considerations regarding the feasibility and costs, economic and otherwise, of obtaining such relief. Finally, we provide an overview of the Treasury Direct Lending Program Under Section 4003 of the Act. We have also addressed the responses and relief measures being provided by the Export-Import Bank of the US in a separate Squire Patton Boggs [analysis](#).

Federal Reserve Facilities

Overview of the Federal Reserve Financial Assistance Programs in the CARES Act

As a threshold matter, the Act permits the Secretary of the Treasury to use US\$454 billion to provide financial assistance to support funding and liquidity facilities established by the Federal Reserve. The Federal Reserve, with the concurrence of the Secretary of the Treasury, has pre-existing statutory authority pursuant to Section 13(3) of the Federal Reserve Act (Section 13(3)) to establish and support broad-based lending facilities (i.e., not designed for the purpose of aiding a particular failing firm and in which at least five entities would be eligible to participate) as long as:

- The businesses or entities are solvent;
- The credit is collateralized (i.e., sufficient to protect taxpayers from losses); and
- The extension of credit is subject to a penalty rate (i.e., a level that is a premium to the market rate in normal circumstances, affords liquidity in unusual and exigent circumstances, and encourages repayment and discourages use of the program as circumstances normalize).

In addition to the terms and conditions established by the Federal Reserve in connection with each Section 13(3) facility, any entity that receives support from a new facility established by leveraging Treasury funding provided by the Act must comply with the following restrictions:

- Neither the company nor any affiliate will engage in stock buybacks until 12 months after the loan or loan guarantee is no longer outstanding, except to the extent required by contract in effect as of March 27, 2020;

- The company will not pay dividends on common stock until 12 months after the loan or loan guarantee is no longer outstanding; and
- The company will not increase the compensation of any officer or employee whose total 2019 compensation exceeded US\$425,000, or provide severance pay or other benefits upon termination of employment of more than twice the maximum total annual compensation received by that employee, until one year after the loan is no longer outstanding. Additionally, officers or employees who were paid over US\$3 million in 2019 may not be paid more than US\$3 million plus 50% of the amount their 2019 compensation that exceeded US\$3 million until one year after the loan is no longer outstanding.

Although the Treasury Secretary has the authority to determine that the waiver of such restrictions is in the interests of the US, he would need to explain this determination to Congress and potentially pay a steep political price.

As for the Main Street Lending Program – which will support lending to small and mid-sized businesses with up to 10,000 employees or revenues up to US\$2.5 billion – there are additional considerations to take into account. As discussed in greater detail below, these loans do not require payment of the loan principal or related interest during the first year after the loan is made – a longer timeframe than the six-month period provided for in the Act. That said, these loans may also carry additional requirements worthy of consideration, including that each entity must make reasonable efforts to maintain its payroll and retain its employees during the loan term. Importantly, though, certain requirements called for under the Act – namely those regarding outsourcing of jobs and union-related issues – are not included in the term sheets. In a separate [update](#), we discuss key considerations for private equity sponsors and portfolio companies in connection with the Main Street Lending Program.

Given the expedited timeline under which the Act was drafted and is being implemented, and judging from our experience thus far with PPP loans (see our [alert](#) for additional information on that program), it is likely that further clarification and additional guidance will be needed.

Main Street Lending Program (MSLP)

Overview

On April 9, 2020 the Federal Reserve published two term sheets for the Main Street Lending Program (MSLP), which will be funded by two Federal Reserve facilities. The MSLP is intended to provide support for small and mid-sized businesses through four-year loans from Eligible lenders to US companies with up to 10,000 employees or with revenues of up to US\$2.5 billion. The two facilities of the MSLP will be funded by an SPV (“Main Street Lending SPV”) capitalized with US\$75 billion in equity from the Treasury through the Act, and up to an additional US\$525 billion in loans from a Federal Reserve Bank through Section 13(3) to the Main Street Lending SPV¹. The Main Street Lending SPV will purchase 95% participations in eligible loans, with lenders keeping a 5% interest in such loans.

¹ The Federal Reserve Bank will make the loans to the SPV on a recourse basis to the SPV, such that the Treasury’s equity will act as first-loss capital.

Eligible lenders may originate new Main Street loans through the Main Street New Loan Facility (New Main Street Loans) or use Main Street loans to increase the size of existing credit facilities through the Main Street Expanded Loan Facility (Main Street Loan Increases). The terms of the two facilities share many common features (and are still subject to final rules and regulations), but there are currently important differences (further outlined below) that provide for more flexibility for the Main Street Expanded Loan Facility. In both facilities, the borrowers and lenders will be required to make certain certifications, including that the Main Street loans will not refinance existing indebtedness or otherwise replace existing credit available to the borrowers. A diagram of the overall MSLP structure is annexed below.

General Terms of Main Street Loans and the Main Street Lending Program

- Total Program Size: Up to US\$600 billion (as of April 9, 2020)
- Lender Eligibility: US-insured depository institutions, US bank holding companies and US savings and loan holding companies.
- Program Termination: – The MSLP intends to stop purchasing participations on September 30, 2020.
- Borrower Eligibility:
 - Up to 10,000 employees or up to US\$2.5 billion in 2019 revenue (thus including entities that are eligible for PPP loans and perhaps EIDL loans under applicable Small Business Administration (SBA) [programs](#));
 - Borrower formed in or under the laws of the US;
 - Borrower has significant operations in the US and a majority of employees based in the US; and
 - Borrower may not also participate in the PMCCF or more than one Main Street Lending Facility – that is, the same Borrower may not get both New Main Street Loans and Main Street Loan Increases (but Borrower may receive a PPP Loan if eligible).
- Terms and Conditions of Main Street Loans:
 - SPV Participation: The Main Street Lending SPV will purchase a 95% participation of eligible term loans at par value (in the case of Main Street Loan Increases, in the upsized tranche) – though it is currently unclear when funding of that participation would occur as compared to funding of the term loan to the Borrower;
 - Maturity: Four year maturity;
 - Payment Deferral: No principal or interest payments for one year;
 - Interest Rate: Adjustable rate of Secured Overnight Financing Rate (SOFR)² + 2.5% to 4.0%;
 - Minimum size of loans: US\$1 million;
 - Prepayment: No prepayment penalty;

² We note that the vast majority of existing credit agreements use LIBOR (and not SOFR) as the current reference rate, although many include a (potential) SOFR option after LIBOR is no longer available. There may be some concern by lenders of whether SOFR is ready for such widespread use, and using SOFR also raises questions relating to incorporating a SOFR tranche into an existing loan that is based on LIBOR.

- Pari Passu Risk Sharing: Main Street Lending SPV and the Lender will share risk on an equal basis (in the case of the Main Street Expanded Loan Facility, in the Main Street Loan Increase);
- Loan Origination Fee: The Borrower will pay the Lender an origination fee of 1.0% of the principal amount of the New Main Street Loan or Main Street Loan Increase; and
- Servicing Fee: The Main Street Lending SPV will pay the Lender 0.25% (25 bps) of the principal amount of the SPV's participation in the New Main Street Loan or Main Street Loan Increase per year for loan servicing.
- Required Certifications. Main Street loans require attestations from the Lender and the Borrower:
 - Proceeds/Payment of other debt:
 - The Lender may not permit proceeds of the Main Street loan to be used to repay or refinance pre-existing loans or lines of credit made by the Lender to the Borrower (including the existing portion of loans that are increased);
 - The Borrower may not use the proceeds of the Main Street loan to repay the balance of other loans; and
 - The Borrower may not repay other debt (unless the debt is senior in priority to the Main Street loan)³, with the exception of mandatory principal payments, unless the Borrower has first repaid the Main Street loan (or upsize) in full. It is not clear if mandatory payments can be amended prior to, at, or after the making of the Main Street loan to get around the repayment restrictions.
 - No Reduction of other Credit: the Lender must not cancel or reduce existing credit facilities to the Borrower, and the Borrower may not seek to cancel or reduce any existing credit facilities. No guidance has been given for how long this prohibition applies or under what circumstances it can be ignored.
 - Effect of COVID-19: the Borrower must attest that the financing is necessary because of COVID-19.
 - Employment Retention: Borrower must make reasonable efforts to maintain its payroll and retain its employees during term of the Main Street loan (using proceeds of the Main Street loan to that effect).
 - Maximum Leverage: Borrower must attest that the applicable Maximum Leverage test (set forth below) is met (4x 2019 EBITDA for new loans and 6x 2019 EBITDA for upsizes of existing loans).
 - Stock repurchase, capital distribution, dividend and employee compensation restrictions on the borrower (as outlined above in the Overview of the Federal Reserve Facilities):
 - No Conflicts of Interest: Both the lender and the borrower must attest that they are not controlled by certain US government officials (or their family members), as set forth under Section 4019(b) of the Act.

³ The term sheets state that the Eligible Borrower must commit to refrain from repaying other "debt of equal or lower priority" without defining what is included in "debt".

Key Differences Between the Two Facilities of the Main Street Loan Program

New Main Street Loans differ in a few key respects from Main Street Loan Increases, in respect of their maximum size, ability to be collateralized and the charging of a facility fee.

- New Main Street Loans vs Main Street Loan Increases:
 - New Main Street Loans are term loans made on or after April 8, 2020. These loans are seemingly intended for new credit facilities that are particularly designed to be eligible for this Main Street facility, and would be documented in a new credit/loan agreement.
 - Main Street Loan Increases are made by increasing/upsizing a tranche of an existing term loan, which original loan was made by the Lender prior to April 8, 2020. Main Street Loan Increases have additional flexibility because these loans can be documented inside of existing credit/loan agreements (by means of amendment).
- Size:
 - New Main Street Loans are capped at the lesser of (1) US\$25 million, (2) the amount that, when added to existing outstanding debt and committed but undrawn debt⁴, does not exceed 4x EBITDA (Maximum Leverage).
 - Main Street Loan Increases are capped at the lesser of (1) US\$150 million, (2) 30% of outstanding bank debt and committed but undrawn bank debt, and (3) the amount that, when added to existing outstanding debt and committed but undrawn debt, does not exceed 6x EBITDA (Maximum Leverage).
 - It is unclear whether the MSLP will have its own definition of EBITDA or what types of adjustments/enhancements to EBITDA, if any, will be permitted.⁵
- Collateral:
 - New Main Street Loans are to be unsecured.
 - Main Street Loan Increases must be secured if the original loan is secured (regardless of whether the collateral was pledged prior to or at the time of the Main Street Loan Increase), and collateral securing the loan will secure the loan participation on a pro rata basis.
- Facility Fee⁶:
 - New Main Street Loans are subject to a 1% facility fee to be paid by the Lender to the Main Street Lending SPV, which the lender may charge to the borrower.
 - No Facility Fee is mentioned for Main Street Loan Increases.

⁴ We note that the 30% condition for Loan Increases references "bank debt," but the Maximum Leverage tests only use "debt".

⁵ We note the possibility that the guidance will follow the Interagency Guidance on Leveraged Lending, which acknowledges adjustments to EBITDA, with reasonable support, may be made, but does not define EBITDA, and considers "large percentage" adjustments to EBITDA to be red flag.

⁶ Additional guidance is needed as to whether lenders may charge borrowers fees in excess of, or in addition to, the fees mentioned the term sheets.

Given the differences between New Main Street Loans and Main Street Loan Increases, lenders and borrowers with existing lending relationships will need to decide whether new loans should be documented as Main Street Loan Increases or New Main Street Loans (with the same lender or with a different lender), though we assume that, given the additional flexibility provided by Main Street Loan Increases and the information we have now, most will favor that path. The related analysis will include considerations relating to the size of the loan needed, the current debt structure of the company, whether collateral securing the existing loans should secure the new loans, the maturity of the existing loan (Main Street Loan Increases have a four year maturity which might not match), the extent of the amendments to current credit agreement(s) that would be needed and the payment of the facility fee.

Other Considerations for the Main Street Lending Program

Given the references to “direct loans” in Section 4003 of the Act, it is not entirely clear whether multi-lender, syndicated loans will also be eligible for Main Street Loan Increases.⁷ Most existing bank loans would presumably have been originated in the ordinary course of business by a financial institution, and many would have been documented in syndicated or club deals. If Main Street Loan Increases also need to meet the “direct loan” standard,⁸ many borrowers and existing credit facilities would be excluded, both because the loans are syndicated and because they were made by a financial institution in the ordinary course of business. If, as we assume to be the case, Main Street Loan Increases do not need to be “direct loans” (and syndicated loans are thus included in the MSLP), a Main Street Loan Increase would affect voting rights among co-lenders, and also raise questions on how co-lenders would allocate the Main Street Loan Increase (and related fees) among themselves.

We are also awaiting guidance regarding the timing of when the Main Street Lending SPV would fund the participations, and when/how the Main Street Lending SPV would communicate to a lender that the Main Street Lending SPV will participate in a particular loan.

If a borrower and lender are expecting to close a new loan in the next few weeks that was not intended to be part of the MSLP, we note that such loan will not be eligible for a Main Street Loan Increase (unless the guidance changes).

The MSLP has not yet been finalized. The Federal Reserve and the Treasury are seeking input until April 16, so the details and terms will likely change to some extent, just as they have for the PPP loan program. This has led to speculation that the MSLP will not launch until May 1.

Primary Market Corporate Credit Facility (PMCCF)

Overview

The Federal Reserve established the Primary Market Corporate Credit Facility (PMCCF) on March 23, 2020 to support credit to employers through the purchase of new bond and loan issuances of up to an aggregate US\$500 billion. The Federal Reserve, through an SPV (the PMCCF SPV) will, on a recourse basis to such PMCCF SPV, (1) purchase qualifying bonds issued by the sole investor in a bond issuance and (2) purchase portions of syndicated loans or bonds at issuance. Bonds and syndicated loans subject to purchase must be issued by an eligible issuer and have a maturity of four years or less. The PMCCF SPV may purchase no more than 25% of any loan syndication or bond issuance, unless the PMCCF SPV is acting as the sole investor in the bond issuance. A diagram of the overall PMCCF structure is annexed below.

Eligible Participants

Eligible Issuers must:

- Be a US Business: organized under the laws of the US with significant operations in and a majority of its employees based in the US, but may not be an insured depository institution or depository institution holding company.
- Have Minimum Credit Rating:
 - Of at least BBB-/Baa3 as of March 22, 2020, by a major nationally recognized statistical rating organization (NRSRO) or, if rated by multiple major NRSROs, the issuer must be rated at least BBB-/Baa3 by two or more NRSROs as of March 22, 2020; and
 - Of at least BB-/Ba3 at the time the PMCCF makes a purchase or, if rated by multiple major NRSROs, such issuers must be rated at least BB-/Ba3 by two or more NRSROs at the time the PMCCF SPV makes a purchase.
- Not Receive Other CARES Act Support – The issuer must not have received specific support pursuant to the Act or any subsequent federal legislation.
- Comply with conflict of interest provisions under the Act.

⁷ Portions of Section 4003 of the Act seemingly only contemplate “direct loans,” *i.e.*, bilateral loans that are not (i) part of a syndicated loan or (ii) a loan originated by a financial institution in the ordinary course of business. *E.g.*, Section 4003(c)(3)(D)(i), and see also Section 4003(c)(3)(A)(ii) of the Act, which states that “The Secretary may make a loan, loan guarantee, or other investment under subsection (b)(4) as part of a program or facility that provides direct loans only if the applicable eligible businesses agree...” and then lists three requirements that are also requirements under the Main Street Lending Program.

⁸ As noted above, “the term ‘direct loan’ means a loan under a bilateral loan agreement that is... not part of a syndicated loan, a loan originated by a financial institution in the ordinary course of business, or a securities or capital markets transaction.” Section 4003(c)(3)(A)(i) of the Act.

Terms of Purchases and Borrowing Limits

- Borrowing Limits:
 - Eligible issuers may refinance outstanding debt from the period of three months ahead of the maturity date of such outstanding debt or may, at any time, request the purchase of additional debt. The maximum amount of outstanding bonds or loans of an eligible issuer may not exceed 130% of its maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020.
 - The maximum amount of instruments that the PMCCF and the SMCCF combined will purchase with respect to any eligible issuer is capped at 1.5% of the combined potential size of the PMCCF and the SMCCF.
- Pricing: will be issuer-specific, informed by market conditions, plus a 1.00% (100 bps) facility fee for the PMCCF purchases (and equal to other members of syndicate loan purchases);
- Program Termination: no new credit extensions will be made after September 30, 2020.

Secondary Market Corporate Credit Facility (SMCCF)

Overview

Like the PMCCF, under the Secondary Market Corporate Credit Facility (SMCCF), the Federal Reserve Bank of New York, through an SPV (SMCCF SPV), will purchase in the secondary market corporate debt up to an aggregate of US\$250 billion issued by eligible issuers. The SMCCF SPV will purchase eligible individual corporate bonds as well as eligible corporate bond portfolios in the form of exchange-traded funds (ETFs) in the secondary market.

Eligible Assets and Issuers

- The SMCCF may purchase corporate bonds that meet each of the following criteria at the time of purchase:
 - Issued by an eligible issuer;
 - Rated at least BBB-/Baa3 by a major NRSRO and, if rated by multiple major NRSROs, rated at least BBB-/Baa3 by two or more NRSROs; and
 - Have a remaining maturity of five years or less.

The SMCCF may also purchase US-listed ETFs whose investment objective is to provide broad exposure to the market for US corporate bonds.

Eligible Issuers: Issuers of individual corporate bonds on the secondary market must:

- Be a US Business: be – Be a business organized under the laws of the US with significant operations in and a majority of its employees based in the US, but may not be an insured depository institution or depository institution holding company.

- Have Minimum Credit Rating:
 - Of at least BBB-/Baa3 as of March 22, 2020, by a major NRSRO or, if rated by multiple major NRSROs, the issuer must be rated at least BBB-/Baa3 by two or more NRSROs as of March 22, 2020; and
 - Of at least BB-/Ba3 at the time the SMCCF makes a purchase or, if rated by multiple major NRSROs, such issuers must be rated at least BB-/Ba3 by two or more NRSROs at the time the SMCCF SPV makes a purchase.
- Not Receive Other CARES Act Support – The issuer must not have received specific support pursuant to the Act or any subsequent federal legislation.

Terms of Purchases and Borrowing Limits

- Borrowing Limits:
 - The maximum amount of bonds that the SMCCF will purchase from the secondary market of any eligible issuer is also capped at 10% of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020.
 - The maximum amount of instruments that the PMCCF and the SMCCF combined will purchase with respect to any eligible issuer is capped at 1.5% of the combined potential size of the PMCCF and the SMCCF.
 - The SMCCF will not purchase shares of a particular ETF if after such purchase the SMCCF would hold more than 20% of that ETF's outstanding shares.
- Pricing: The SMCCF will purchase eligible corporate bonds at fair market value in the secondary market. The SMCCF will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio.
- Program Termination: The SMCCF will cease purchasing eligible corporate bonds and eligible ETFs no later than September 30, 2020.

Municipal Liquidity Facility

Overview

Pursuant to the Municipal Liquidity Facility (MLF), the Federal Reserve will purchase up to US\$500 billion of short-term municipal notes (Eligible Notes) from selected states, counties and cities (Eligible Issuers). Under the MLF, a Federal Reserve Bank will commit to lend to a SPV (Municipal SPV) on a recourse basis, and then the Municipal SPV will purchase Eligible Notes directly from Eligible Issuers. The Department of Treasury will provide an initial equity investment of US\$35 billion to the Municipal SPV in connection with the MLF by using funds appropriated by the Act. Unless further extended, the Municipal SPV will cease purchasing Eligible Notes on September 30, 2020. A diagram of the overall MLF structure is annexed below.

General Terms of Municipal Liquidity Facility:

- Total program size: Up to US\$500 billion (as of April 9, 2020).
- Eligible Issuers: To help states and large counties and cities better manage short-term cash flow pressures during this unprecedented time, the MLF will purchase up to US\$500 billion of short-term Eligible Notes directly from the following Eligible Issuers⁹:
 - US states and the District of Columbia;
 - US counties with a population exceeding 2 million residents; and
 - US cities with a population exceeding 1 million residents.
- Eligible Notes: Eligible short-term notes (subject to the Federal Reserve’s review) include the following:
 - Tax anticipation notes;
 - Tax and revenue anticipation notes;
 - Bond anticipation notes; and
 - Other similar short-term notes that mature within two years from the date of issuance.
- Terms and Conditions of the Municipal Liquidity Facility:
 - Pricing: Pricing the Eligible Notes will be based solely on the Eligible Issuer’s rating at the time of the Municipal SPV’s purchase;
 - Origination Fee: Upon the Municipal SPV’s purchase, the Eligible Issuer will have to pay an origination fee equal to 0.10% (10 bps) of the principal amount of the Eligible Notes purchased by the Municipal SPV, which may be paid from the proceeds of the issuance;
 - Call Right: Eligible Notes are callable by the Eligible Issuer at any time at par;
 - Size limitation: Although the Municipal SPV may purchase Eligible Notes in multiple tranches from an Eligible Issuer, the Municipal SPV may only purchase Eligible Notes from the Eligible Issuer in an amount “up to an aggregate amount of 20% of the general revenue from its own sources and utility revenue of the applicable State, County, or City for fiscal year 2017.” However, upon a request from a state, the Municipal SPV may purchase Eligible Notes in excess of the 20% limit to assist “political subdivisions and instrumentalities” that cannot otherwise directly access the MLF program; and

- Use of Proceed. Eligible Issuers are also limited in how it may use the proceeds from selling its Eligible Notes to the Municipal SPV. Proceeds may be used to:
 - Help manage the cash flow impact of (a) income tax deferrals resulting from an extension of an income tax filing deadline, (b) potential reductions of tax and other revenues related to the pandemic, (c) increases in expenses related to the pandemic, or (d) provide for the payment of principal and interest on debt obligations; and
 - Purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities for any purpose approved for Eligible Issuers.

Term Asset-Backed Securities Loan Facility (TALF)

Overview

First announced in 2008, the Term Asset-Backed Securities Loan Facility (TALF) is a program pursuant to which the New York Federal Reserve Bank, indirectly, will lend on a recourse basis up to US\$100 billion to facilitate the issuance of asset-backed securities (ABS) and improve the ABS market generally. TALF provides financing to investors to support their purchases of certain AAA-rated ABS. On April 9, 2020, the Federal Reserve broadened the range of assets that are eligible collateral for TALF. TALF-eligible collateral will now include the triple-A rated tranches of both outstanding commercial mortgage-backed securities and newly issued collateralized loan obligations.

Eligible collateral must be ABS where the underlying credit exposures consist of:

- Auto loans and leases;
- Student loans;
- Credit card receivables (both consumer and corporate); equipment loans and leases;
- Floorplan loans;
- Insurance premium finance loans;
- Certain small business loans that are guaranteed by the SBA;
- Leveraged loans; or
- commercial mortgages.

Eligible ABS must be issued on or after March 23, 2020. However, commercial mortgage-backed securities (CMBS) issued on or after March 23, 2020, will not be eligible.

Eligible Participants

All US companies that own eligible collateral and maintain an account relationship with a primary dealer are eligible to borrow under the TALF. All or substantially all of the credit exposures underlying eligible ABS must have been originated by a US company, and the issuer of eligible collateral must be a US company. For CMBS, the underlying credit exposures must be to real property located in the US or one of its territories.

⁹ Importantly, each state, county or city can issue Eligible Notes directly or through an instrumentality that issues debt on behalf of the state, county or city for the purpose of managing its cash flows, but only one Eligible Issuer per state, county, or city may participate in the MLF program, and US Territories, including Puerto Rico and US Virgin Islands, appear to be excluded from the MLF program. Additionally, all Eligible Note issuances are subject to review and approval by the Federal Reserve.

Terms of Loans

- Maturity: three years;
- Interest Rate: interest rate and base rate vary by underlying investment;
- Prepayment: pre-payable in whole or in part at the option of the borrower;
- No Collateral Substitution: no substitution of collateral during the term;
- Non-Recourse: loans are without recourse to the borrower as long as the requirements of the TALF are met; and
- Program Termination: no new credit extensions will be made after September 30, 2020.

Practical Considerations for Commercial Mortgage Backed Securities (CMBS) Originators and Borrowers

The revisions to TALF under the Act operate to provide short-term liquidity in the market for previously securitized CMBS loans. During the credit crunch of 2007, the market for CMBS loans was paralyzed because of a lack of liquidity in the market for CMBS bonds and took years to recover. This provision of the Act provides relief for CMBS bonds created prior to March 23, 2020 – meaning any outstanding bonds as of such date will be eligible under the CARES Act. Under the terms of the guidance, as written, lenders of CMBS loans, which have not been securitized (aka “warehouse loans”) do not appear to have the benefit of the Act amendment to TALF. This may be further clarified by the Treasury in the future.

Existing CMBS borrowers/property owners will not be significantly benefited by the Act. Each outstanding loan will continue to be governed by the terms of the applicable loan documents, and the master servicer responsible for servicing each loan will continue to service each loan in accordance with the Pooling and Servicing Agreement for the securitization to which each loan belongs.

For loans that are susceptible to default as a result of the COVID-19 pandemic (e.g., malls, retail-heavy shopping centers, non-FNMA or FMAC multifamily), Borrowers are advised to maintain regular communication with their representative at their master servicer, well in advance of any anticipated default. Master servicers generally have leeway to provide up to 30 days of loan forbearance under special circumstances. However, in the event of a default and a transfer of any loan to the “special servicer,” Borrowers should immediately engage counsel for advice on any negotiations going forward.

Support for SBA’s Payroll Protection Program

While the Small Business Administration’s Payroll Protection Program for small businesses is already deploying capital through a network of authorized private banks and other lenders, the Federal Reserve has also announced a Paycheck Protection Program Lending Facility to support these lenders. Federal Reserve Banks will lend (via PPP Lender Loans) to depository institutions that originate PPP loans using the PPP loans as collateral but otherwise lending on a non-recourse basis. The expected impact of this facility is to allow lenders, who have deployed capital in the PPP program to recoup some of it, maintain liquidity and continue to make loans to businesses, which will benefit the economy.

Terms of the PPP Lender Loans (Made to SBA Lenders):

- Maturity and Acceleration of Maturity: The maturity date of a PPP Lender Loan (made to an SBA Lender) will equal the maturity date of the PPP loan pledged to secure the extension of credit. The maturity date of the PPP Lender Loan will be accelerated if the underlying PPP loan goes into default and the eligible borrower sells the PPP loan to the SBA to realize on the SBA guarantee. The maturity date will be accelerated to the extent of any loan forgiveness reimbursement received by the eligible borrower from the SBA.
- Interest Rate: 35 basis points (0.35%).
- No Fees: There are no fees associated with this facility.
- Collateral Valuation: PPP loans pledged as collateral to secure extensions of credit will be valued at the principal amount of the PPP loan.
- Principal Amount: The principal amount of a PPP Lender Loan (made to an SBA Lender) will be equal to the principal amount of the PPP loan pledged as collateral to secure the PPP Lender Loan (made to an SBA Lender).

Possible Establishment of a Credit Facility for Mid-Sized Businesses

The Act also specifically encouraged the Secretary of the Treasury to support a Federal Reserve credit facility that supports lending to mid-sized businesses (with between 500 to 10,000 employees), but, given its similarity in purpose to the Main Street Lending Program, it is uncertain whether it makes sense to implement a separate mid-sized businesses credit facility, or whether the Main Street Lending Program will fill the role mid-sized businesses credit facility and the Main Street Lending Program referenced in the Act¹⁰.

¹⁰ Our previous [alert](#) covers the provisions of the Mid-Size Business Facility referenced in the Act, which, overall, contains harsher conditions than those set forth in the term sheets for the Main Street Lending Program. There is some thought that utilizing the Main Street Lending Program will allow the Federal Reserve to assist mid-sized businesses without those strings attached.

Conclusion Regarding Federal Reserve Facilities

As noted in its release, the Federal Reserve “remains committed to using its full range of tools to support the flow of credit to households and businesses to counter the economic impact of the COVID-19 pandemic and promote a swift recovery once the disruptions abate.” In taking the actions outlined above, the Federal Reserve is planning to leverage nearly US\$200 billion to offer more than US\$2 trillion in additional liquidity in the markets. Importantly, the Federal Reserve also made clear in taking these various actions that it reserves the right to modify the facilities as needed to address the US’ evolving economic needs. Notably, there remains significant additional funding provided by the Act for the Treasury Department to invest in these and other potential Federal Reserve facilities, which, in turn, could be leveraged by the Federal Reserve. To that end, Federal Reserve Chairman Jerome Powell has indicated that the Federal Reserve is prioritizing emergency lending programs for “those areas of the markets that are most fundamental to supporting the real economy.” However, he also made clear that as other troubled areas are identified – such as the mortgage servicing industry, for example – the Federal Reserve will not hesitate to take additional action. Our team will continue to keep apprised of such developments and provide further analysis as additional information is made available.

Treasury Direct Lending Program

Overview

The Act authorizes the Secretary of the Treasury to provide up to US\$46 billion of direct loans, loan guarantees and other investments to certain essential businesses, including:

- US\$25 billion for passenger air carriers, businesses that inspect, repair and maintain aircraft, and ticket agents;
- US\$4 billion for cargo air carriers; and
- US\$17 billion for businesses that are “critical to maintaining national security.”

Eligibility

To be eligible for a direct loan, loan guarantee or investment from the Treasury Department, the Treasury Secretary must determine that an air carrier or national security firm meets the following conditions:

- No Credit Elsewhere. Alternative financing is not reasonably available for the company;
- Security/Interest Rate. The loan or loan guarantee is secured or made at an interest rate that reflects the risk of the loan (in addition to the financial protection referenced below);
- Term. The duration of the loan or loan guarantee is as short as possible and not more than five years;
- No Stock Buybacks. The company and any affiliate will not engage in stock buybacks until 12 months after the loan or loan guarantee is no longer outstanding, except to the extent required by contract in effect as of the date of enactment;

- No Dividends. The company will not pay dividends on common stock until 12 months after the loan or loan guarantee is no longer outstanding;
- Employment Levels. The company will maintain the employment level that existed on March 24, 2020 to the extent practicable until September 30, 2020, and in any case will not reduce its employment level by more than 10% of the level that existed on March 24, 2020;
- US Business. The company is organized in the US, has significant operations in the US, and has a majority of its employees in the US;
- Covered Losses. The company has incurred or is expected to incur covered losses such that the continued operations of the business are jeopardized;
- Compensation. The company will restrict total compensation of certain highly paid officers and employees until 12 months after the loan or loan guarantee is no longer outstanding (as is the case for Federal Reserve Facilities as outlined above); and
- Continuation of Certain Air Service. Companies that are air carriers must maintain scheduled air transportation service deemed necessary to ensure services to any point served by that air carrier before March 1, 2020.

From a business standpoint, the restrictions on paying dividends and stock buybacks may well result in investors avoiding further investments in those sectors that are subject to these prohibitions, which could potentially make these businesses more reliant on the government for financial support.

Also, in order to offer financial protection to the federal government, the Treasury Department must receive a warrant or an equity interest if the borrower is a public company, or, if the borrower is a private company, a warrant, equity interest or a senior debt instrument that the Treasury Secretary – in his sole discretion – deems to be appropriate.

Another issue that is determined at the discretion of the Treasury Secretary is the appropriate interest rate based on the risk of the loan or loan guarantee. Under existing regulatory authority, the Treasury Department may make a determination as to the types and valuation of acceptable collateral. Pursuant to the Act, the interest rate must reflect the risk of the loan and, to the extent “practicable,” not be less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of the COVID-19 pandemic.

Another condition that comes along with a loan or loan guarantee from the Treasury Department: annual compensation limits for officers and employees until 12 months after the loan ceases to be outstanding. Beyond the impact this restriction on compensation will have on the most senior-level executives, another practical implication is the potential negative impact this will have on a company’s ability to attract employees at the second and third levels of the organization.

Application and Other Procedures

The Treasury Department issued preliminary [guidance](#) on March 30, 2020, and also released a [FAQ](#) dated April 6, 2020, as well as a draft loan [application](#) form for informational purposes for air carriers and related eligible borrowers (however it was not, as of such time, accepting applications, and was planning on providing a web-based application on its website in the coming days). The Treasury Department has stated that it will issue supplemental guidance on additional rules and policies, certifications and disclosures required by borrowers, loan terms and conditions, information on loan sizing, and application evaluation criteria. From our perspective, the politics surrounding this program suggest that the application and approval process likely will be quite intensive and public facing, though the Treasury Department has stated that it only intends to make applications publicly available to the extent required by law.

Given the urgency in the economy for liquidity, and the lack of capacity for Treasury and the Federal Reserve to process, review and fulfill the sheer volume of requests for assistance that are anticipated, both Treasury and the Federal Reserve will need assistance from private sector companies to implement these programs in an expedited manner. However, due to oversight interests by Congress, the Act establishes within the Treasury Department an Office of the Special Inspector General for Pandemic Recovery, which will conduct, supervise and coordinate audits and investigations of the financial assistance provided by the Treasury Secretary. The Special Inspector General is required to provide quarterly updates to Congress that provide the details of all such financial assistance.

Additionally, the Act establishes a Congressional Oversight Commission (Commission) charged with oversight of the Treasury Department and the Federal Reserve in their efforts to provide economic stability in the face of the ongoing and evolving threats stemming from the COVID-19 pandemic. As part of its oversight efforts, this Commission is authorized to secure from any federal department or agency information it deems necessary to carry out its oversight responsibilities. Moreover, the Commission must submit reports to Congress every 30 days specifying:

- The impact of purchases on the financial wellbeing of the people of the US, financial markets and financial institutions;
- The extent to which the information made available on transactions has contributed to market transparency; and
- The effectiveness of the financial assistance provided under this title of minimizing long-term costs to the taxpayer and maximizing the benefits for taxpayers.

In light of the draft application and the information that Congress is likely to request from the Treasury Department, the Federal Reserve and others, we expect that applications for direct financial assistance will likely require substantial information – which may be made publicly available – addressing the above-mentioned points that must be addressed in the Commission's monthly report to Congress. As such, applicants would be advised to consider how making such information public could impact business. To the extent an eligible business does wish to seek loans or loan guarantees directly from Treasury, it should review the draft application referenced above and begin collecting the relevant information.

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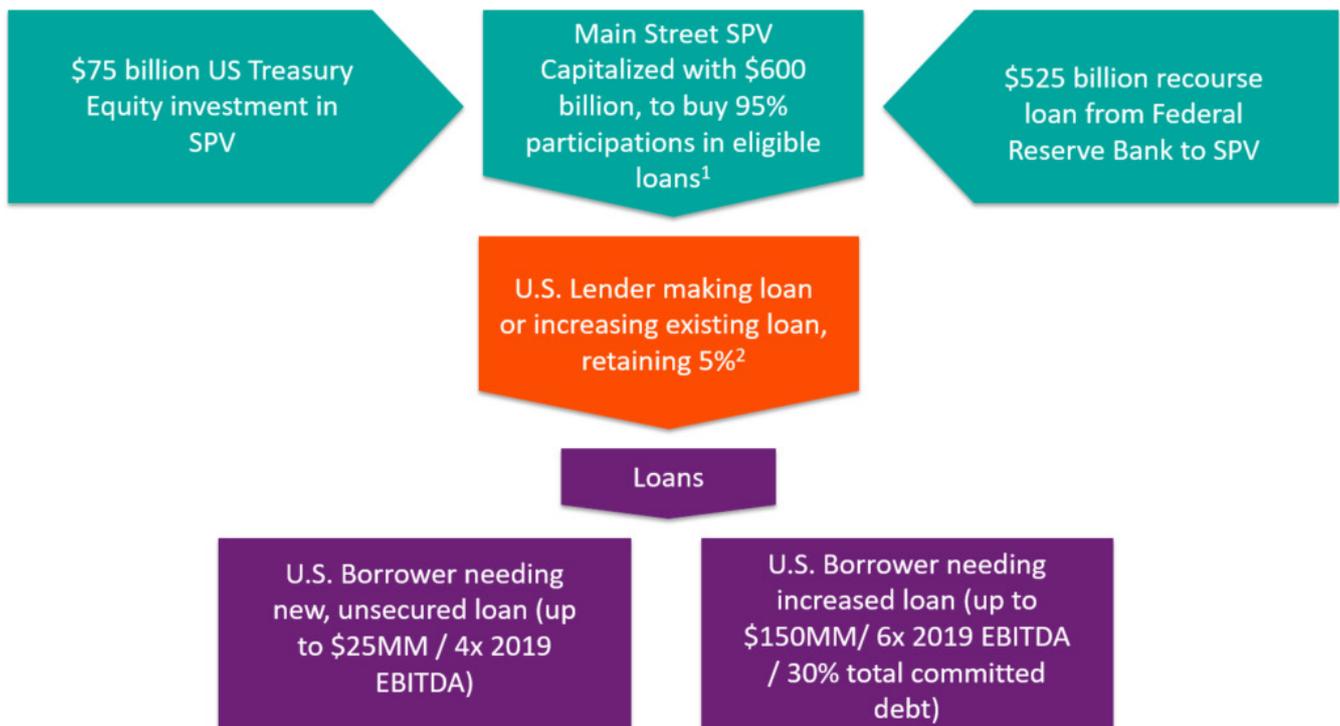
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Annex Diagrams

Main Street Lending Program



¹ SPV purchases a 95% participation in the loan from the lender, pays a 0.25% per year servicing fee to the lender, and in the case of new loans, receives a 1% facility fee.

² Bank receives a payment for the 95% participation in the loan from the SPV, plus an origination fee of 1% from the Borrower.

Primary Markets Corporate Credit Facility



¹ Issuer must (i) be a US entity with significant operations in and a majority of its employees based in the United States, (ii) be rated at least BBB-/Baa3 as of March 22, 2020, by a major nationally recognized statistical rating organization ("NRSRO"). If rated by multiple major NRSROs, the issuer must be rated at least BBB-/Baa3 by two or more NRSROs as of March 22, 2020, and must be rated at least BB-/Ba3 at the time of purchase and (iii) not be not an insured depository institution or depository institution holding company. Other prohibitions under the Act apply.

² SPV purchases eligible bonds and syndicated loans with maturities of 4 years or less. SPV may purchase no more than 25 percent of any loan syndication or bond issuance, except in the case the SPV is the sole investor in a bond issuance. Pricing on (i) bond issuances will be issuer-specific, informed by market conditions, plus a 100 bps facility fee and (ii) syndicated loans will be the same as other syndicate members, plus a 100 bps facility fee on the SPV's share of the syndication. Purchases from an eligible issuer 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 and is capped at 1.5 percent of the combined potential size of the PMCCF and the SMCCF.

Municipal Liquidity Facility

Department of Treasury
Initial \$35 billion equity investment to the Municipal SPV

Municipal SPV
Capitalized with up to \$500 billion to buy Eligible Notes¹

Federal Reserve
Up to \$465 billion recourse loan to the Municipal SPV

Eligible Issuers²

- U.S. states and the District of Columbia;
- U.S. counties with a population exceeding 2 million residents; and
- U.S. cities with a population exceeding 1 million residents.

*The Municipal SPV may only purchase Eligible Notes from the Eligible Issuer up to an aggregate amount of 20% of the general revenue from its own sources and utility revenue for FY 2017 (the "20% Limit").

Eligible Issuers May Use the Proceeds as Follows:

- Help manage the cash flow impact of:
 - income tax deferrals resulting from an extension of an income tax filing deadline,
 - potential reductions of tax and other revenues related to the pandemic,
 - increases in expenses related to the pandemic, or
 - provide for the payment of principal and interest on debt obligations; or
- Purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities for any purpose approved for Eligible Issuers.

*Upon request from a State, the Municipal SPV is not restricted from purchasing more than the 20% Limit of a State's Eligible Notes if such proceeds are used to assist "political subdivisions and instrumentalities."

¹ Short-term eligible notes to include: Tax anticipation notes; tax and revenue anticipation notes; bond anticipation notes; and other similar short-term notes that mature within 2 years from the date of issuance.

² Each state, county, or city may issue Eligible Notes through an instrumentality that issues debt on behalf of the state, county, or city for the purpose of managing its cash flows.

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