Main Street New Loan Facility and Main Street Expanded Loan Facility
Key Comments on April 9, 2020 Term Sheets

Introduction

The Bank Policy Institute¹ appreciates the opportunity to comment on the term sheets for the MSNLF and MSELF. We believe these facilities have the potential to provide significant and rapid relief to a large number of small- and medium-sized enterprises and their employees, thus furthering the policy expressed by Congress in the CARES Act to provide broad support to the real economy.

Our members have a strong interest in establishing the MSNLF and MSELF as facilities that function effectively for as large a number of eligible borrowers as possible. To that end, it will be important for the two facilities to be flexible in structure and consistent with current market practices wherever possible in order not to unnecessarily exclude otherwise eligible borrowers.

In particular, it will be important for these facilities to:

- Be available to a wide range of enterprises, including hospitals and other non-profits, as well as businesses for which an EBITDA-based leverage ratio is not an appropriate credit metric or that have credit arrangements other than term loans. Many of these businesses may be excluded from the facilities based on the April 9 term sheets. For example, many early-stage growth companies will not have EBITDA while many businesses, particularly small businesses, will not have term loan facilities, but instead have revolving credit facilities, asset-based facilities, privately placed notes, or other forms of debt financing.

- Work within the framework of borrowers’ existing debt arrangements and not preclude borrowers from subsequently accessing private debt markets. Many borrowers’ existing debt arrangements contain covenants that limit the ability of those borrowers to incur debt or grant liens, subject to specified exceptions. If the facilities are constituted in an overly prescriptive manner, many borrowers will not qualify for the facilities, or may need to obtain amendments or waivers in order to participate. Amendments or waivers may be difficult to obtain, particularly for borrowers with broadly syndicated loan facilities or capital markets debt.

¹ The BPI is a nonpartisan public policy, research and advocacy group, representing the nation’s leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they make nearly half of the nation’s small business loans.
• Take into account the fact that non-bank and non-U.S. institutions are active lenders to small- and medium-sized enterprises, and participate in existing loans alongside regulated lenders, or as syndication participants. In particular, borrowers should not be precluded from accessing the MSELF just because some of their existing lenders are non-bank entities.

With this background in mind, we have set forth below our key comments on the April 9 term sheets. We will follow up with further suggestions for optimizing the facilities and clarifying certain requirements by April 16.

The comments listed below are those that we believe are essential to resolve in order for the facilities to be successful. Accordingly, most of the points discussed below are directed at ensuring that the facilities are available to as broad a range of otherwise eligible borrowers as quickly and as seamlessly as possible. At the same time, the program must be transparent that underwriting by the participating lenders is an important component of the program’s design with the intent of limiting taxpayer losses. Therefore, not all borrowers that meet the criteria provided in the term sheets will receive loans or receive loans for the maximum allowable amount.

Finally, in addition to making sure the facilities are accessible to borrowers, it will be important for participating lenders to have clarity as to the scope of their responsibilities as originators of loans under the program and with respect to ongoing loan administration. Participating lenders will also need to understand the material terms of the participation agreement, including any obligation to reacquire the SPV’s 95% risk participation.

If you have any questions or would like to discuss any of the comments below, please contact Lauren Anderson, Senior Vice President and Associate General Counsel, at lauren.anderson@bpi.com.

Key Comments

1. **Applicable Rate** – Rather than creating additional complexity for both borrowers and lenders by requiring immediate use of SOFR, we propose that eligible loans adopt the approach that is current market practice and initially use LIBOR with “fallback” provisions for transitioning to SOFR consistent with either of the ARRC’s approved options. Borrowers and lenders would then set the rate, including a spread within the specified range and any applicable floor, based on the circumstances of each eligible loan.

   • The great majority of U.S. corporate loans currently use LIBOR, with provisions permitting the agent to move to a replacement rate when LIBOR is no longer published or an alternative rate (e.g., SOFR) is generally in use.

   • As a result, most borrowers are familiar with LIBOR-based lending and have not yet prepared for a transition to an alternative rate. Requiring that eligible loans use SOFR would result in a need for significant borrower education, adding
complexity at an already challenging time, and may discourage borrowers from accessing the facilities or delay their ability to do so.

- There is not yet a widely accepted SOFR rate in the corporate loan market, and hedging for simple SOFR is not readily available, which limits the ability to mitigate interest rate risk and so may discourage participation by both borrowers and lenders in the facilities.

- Furthermore, many lenders, particularly small- and medium-sized lenders, are not yet ready operationally to transition to SOFR and so would be unable to participate in the facilities. System and operational changes have been based on plans for year-end 2020, in anticipation of the December 31, 2021 date set by the official sector for LIBOR cessation, and many lenders are still in the process of integrating and testing new services from vendors for use with SOFR-based business loans. Requiring that program loans use SOFR would effectively accelerate SOFR adoption by nine months for this product. We suggest that prudential considerations weigh against a hurried alteration of system and operational plans, especially in light of the current circumstances.

- At the same time, requiring eligible loans to use the approaches proposed by the ARRC will support the policy objective of moving credit agreements to effective LIBOR replacement wording.

2. **Determinations on Borrower Creditworthiness** – Program documentation should make clear that lenders participating in the program may continue to apply lending criteria based on the relevant lender’s credit analysis and underwriting standards in addition to the express requirements of the program. This approach will help to protect the taxpayer and promote institutional safety and soundness.

- Eligible lenders should not provide funds to every borrower that satisfies the limited set of eligibility criteria set forth in the term sheets. Rather, lenders should continue to apply lending criteria and be able to include covenants and other terms that go beyond those specified in the term sheets to the extent deemed appropriate based on the relevant lender’s credit analysis and underwriting standards (so long as such criteria and covenants or other terms do not expressly conflict with the term sheets). Applying such standards will serve the interest of taxpayer protection and support institutional safety and soundness.

- Of course, although the lenders will attempt to apply underwriting standards that minimize the risk of loss on eligible loans, the policies behind the program, including funding for a wide range of borrowers, speed of execution and employee protection, will often require the application of underwriting standards that differ from those that are usual, particularly with respect to current performance and projections. Accordingly, an eligible loan to an eligible borrower that complies with the specific terms of the program should not result in liability by the lender to the Federal Reserve, Treasury or the SPV for any default on such eligible loan absent manifest willful misconduct on the part of the lender.
Note that we will be seeking additional clarification on underwriting standards in our subsequent comment letter.

- Finally, to avoid borrower confusion, we recommend that the relevant program documentation, including any application forms, make clear that receipt of funds under the program will be conditional upon satisfying applicable lending standards and that applicants may therefore not receive the maximum loan amount or indeed any funds under the program.

3. **EBITDA** – Rather than the EBITDA construct included in the term sheets, we propose that borrowers and lenders be permitted to use the metric most comparable to EBITDA in the relevant borrower’s existing credit arrangements or regular financial reporting, or a metric in common use in credit arrangements in the borrower’s industry to the extent more appropriate.

- The corporate loan market generally uses an “adjusted” EBITDA framework, which permits add-backs of non-cash items and other items in order to try to establish a more accurate picture of cash flow available to service debt, with the add-backs in question tailored to each borrower based on that borrower’s business. There are also sectors, such as real estate, for which EBITDA-based metrics are not commonly used.

- The proposed EBITDA construct would not be appropriate for many borrowers and would not result in a consistent measurement of risk across borrowers in different businesses. Requiring all borrowers to use the same credit metric to determine eligibility would exclude many sound entities from the facilities, including non-profits.

4. **Leverage** – Even with the above adjustments to EBITDA, the leverage tests contemplated by the term sheets may be too restrictive for many eligible borrowers.

- In particular, the low caps on leverage would preclude many young, innovative companies that currently have low or no income but promising growth prospects from accessing the facilities. Such firms contribute importantly to employment and productivity.

- Furthermore, the definition of “debt” for the purpose of these leverage calculations will need clarification in order to avoid unnecessarily shrinking program availability. For example, market participants do not typically include undrawn commitments in their leverage calculations, and particularly in the current circumstances, “drawn commitments” would provide an accurate measure of a firm’s likely indebtedness under stress.

- In addition, clarity will be needed on whether “debt” will include on-balance-sheet leases and contingent obligations and whether it will be calculated net of cash, while for the MSELF, clarity will be needed on whether the 30% cap is
limited to “bank” debt or can also include other forms of debt that may be outstanding (such as bonds and loans provided by non-traditional lenders).

- Consistent with recent agency statements, we assume that the 2013 leveraged lending guidance will not be enforced as binding rules with respect to loans under the program. Not requiring strict adherence to the guidance will facilitate quicker underwriting decisions, for example by allowing lenders to forego preparation of the detailed projections suggested by the guidance. Such projections take time and would be challenging to develop accurately in the current economic environment.

5. **Tenor** – Rather than fixing the tenor at four years, the program should permit lenders and borrowers to agree to tenors for any period up to six years, with amortization schedules after the initial year of the loan to be agreed between the relevant borrower and its lenders.

- Loans with a fixed four-year tenor are less likely to be permitted by a company’s existing indebtedness, as there are frequently requirements that new debt have a tenor that matches or exceeds that of existing debt. Given that term loans frequently have a tenor of five years or longer, a significant amount of existing debt would prohibit borrowers from utilizing these facilities.

- At the same time, even if a four-year loan were permitted under existing arrangements, it may be difficult for companies to borrow privately for longer periods of time subsequent to the COVID-19 situation resolving itself, as lenders will be reluctant to provide financing when the program loans have structural priority due to their earlier tenor.

- A fixed four-year tenor could also result in a large number of borrowers having loans with similar maturities, resulting in a maturity wall with many borrowers needing to refinance at the same time.

6. **Amortization** – We believe there is a need for additional clarity around the operation of the one-year interest and principal deferral as well as the implications for borrowers’ obligations in the post-deferral period.

- To be able to underwrite the loans, lenders will need clarity that:
  - Amortization after the deferral period will be negotiated between the borrower and its lenders in order to best serve the borrower from a cash flow perspective.
  - Deferred interest will be accreted to principal at the relevant interest payment date, in accordance with market practice.
  - Interest will accrue on the deferred principal and deferred interest that has been accreted to principal (i.e., paid in kind).
Lenders and borrowers may agree that interest be paid in kind for some period after the initial one-year deferral.

7. **SPV Participation** – There is a need to have clarity on the material terms of the participation agreement that addresses key issues common to all lenders.

   - Issues to address include practical matters relating to how the loan will be administered, including what rights the SPV will have as participation holder to vote or consent under the relevant loan agreement, what obligations the bank will have to the SPV and rights and responsibilities in relation to a borrower default.

   - The participation agreement will also need to include limitations on liability and other customary terms.

   - A critical unknown is whether lenders will need to sell the 95% participation to the SPV upon origination of an eligible loan or will have the option of electing to sell the participation at par for as long as the facility is open and irrespective of the relevant loan’s performance over the period between loan origination and sale to the SPV. Clarity on this point is crucial because the facilities will operate significantly differently depending on which of the two alternatives is chosen.

8. **Attestation Requirements** – Lenders should be permitted to rely on each borrower’s attestations as to program requirements without further verification.

   - In order to be able to participate in the facilities, lenders will need to understand what responsibility (and resulting potential liability) they have to verify or monitor borrower attestations as to program requirements, including forward-looking requirements, such as the requirement to use “reasonable efforts” to maintain payroll and retain employees. To the extent that lenders are required to verify borrower attestations, delays will occur as lenders build the requisite compliance processes, and put each potential borrower through that process.

   - Lenders will also need clarity as to where the various attestations will need to be housed (e.g., in loan applications, loan documents or separate certificates).

   - Permitting lenders to rely on borrower’s attestations will facilitate a quicker roll-out of the facilities.

   - We request that the Federal Reserve Board work with the Treasury and FinCEN to provide the same relief to lenders with regard to KYC obligations for existing clients that has been provided for the Paycheck Protection Program through recent FAQs. It would also be helpful to have such relief extended to new borrowers as well to expedite the ability to provide funding to companies in need.

9. **Accounting and Capital and Regulatory Treatment** – Participating lenders will need confirmation that the SPV’s participation will function as a “true sale” of 95% of the
relevant loan, so that only the 5% retained economic interest is included when a bank calculates risk-based capital and leverage ratios.

10. **Operational Issues** – There are a significant number of additional operational issues related to loan origination and documentation that will need to be worked through, on which we will be providing further comments.