BANK POLICY INSTITUTE

May 5, 2020

Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Re: April 30, 2020 Term Sheets and FAQ for the Main Street Lending Program[1]

Ladies and Gentlemen:

The Bank Policy Institute[2] welcomes the updated term sheets for the Main Street Lending Program. We believe that the updated term sheets represent a significant advance towards an effective program that can provide the relief needed by small- and medium-sized enterprises. We also welcome the guidance contained in the FAQs, which provides useful clarifications relating to the program requirements and answers many of the questions our members had previously raised. This letter supplements our letter on lender liability and rights and obligations associated with the relevant program documentation, which we submitted on May 1, 2020.

We are continuing to analyze the details of the updated term sheets and related FAQs, and will be submitting questions for further clarification as needed. Many of these questions will relate to the application of the program requirements to particular situations and can likely be addressed in additional FAQs.

In advance of that submission, we wanted to raise five specific issues resulting from the updated term sheets and related FAQs that we believe require revision or clarification before the program is finalized if the program is to be able to achieve its full potential.

In addition, we wanted to reiterate our recognition of the need to strike a balance between maximizing the reach of the program by making it available to as many borrowers as possible and protecting the interests of taxpayers through, among other things, imposing limits on the terms on which program loans may be extended. This objective is reflected in the program's structural elements; however, in certain instances the terms may be too restrictive and therefore limit the attraction of the program to potential borrowers and lenders. We believe there are modifications that could be made to certain of the facilities' terms that would not unduly increase the risk to

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1 For purposes of this letter, the Main Street Lending Program includes each of the Main Street New Loan Facility ("MSNLF"), the Main Street Expanded Loan Facility ("MSELF") and the Main Street Priority Loan Facility ("MSPLF"). Capitalized terms used and not otherwise defined herein have the meaning set forth in the term sheets for the MSNLF, the MSELF and the MSPLF dated April 30, 2020.

2 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 employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

taxpayers, but would significantly increase the attractiveness of the facilities. These modifications relate to loan priority, tenor and pricing, and suggestions in relation to these matters are set forth below.

I. MSPLF

We welcome the introduction of the MSPLF and believe it has the potential to expand the reach of the program by allowing Eligible Borrowers with higher leverage but no ability to take advantage of the MSELF to participate. However, some of the required terms of the MSPLF set forth in the MSPLF term sheet could limit its ability to fulfill this potential.

In particular, the requirement that MSPLF loans rank pari passu with, or senior to, an Eligible Borrower's existing debt may make it challenging for Eligible Borrowers with existing debt to access the facility, as it may not be possible to obtain the consents required to allow the MSPLF loans to share in the existing debt's credit support and collateral given dilution concerns. In particular, because MSPLF loans are required to rank at least equally with the Eligible Borrower's existing debt and share in any available collateral, the Eligible Borrower's existing lenders will be diluted in their recoveries in the event of an insolvency even if the existing debt is secured, unless the value of the Eligible Borrower's assets is such that it is able to over-collateralize both its existing debt and the MSPLF loan (in which case it may be able to access private credit markets and not require the program). This dilution concern may be heightened at the present time given the increased uncertainty and risk of default caused by the COVID-19 pandemic and the fact that there is not yet clarity as to whether there will be any recovery sharing in an insolvency with regard to any additional recoveries provided to the SPV. Thus, existing lenders may have a disincentive to provide the necessary consent for new credit under the MSPLF.[3]

At the same time, the fact that the term sheets provide for identical margins across the three facilities and identical fees across the MSNLF and MSPLF may discourage *lender* participation in the MSPLF because Eligible Lenders will not be compensated for the increased risk resulting from the combination of the higher leverage permitted under the MSPLF and the requirement that Eligible Lenders retain a 15% interest in MSPLF loans, rather than the 5% interest required under the MSNLF and the MSELF.

One simple way to resolve these concerns would be to revise the priority provisions of the MSPLF to match the MSNLF and then allow for a higher margin or higher up-front fees on the MSPLF for both the SPV and the Eligible Lender. Eligible Borrowers would then effectively have a simple choice between a lower leverage option (the MSNLF) and a higher leverage option (the MSPLF), each of which would be flexible enough to respond to the particular needs of a borrower by allowing for both secured and unsecured options but with pricing to match the different risk profiles inherent in the two options. Given their higher, 15% exposure, Eligible Lenders will have a greater incentive under the MSPLF to not allow a borrower to take on excessive leverage. To simplify the choice further, the amortization schedule for the MSNLF could be revised to match that applicable to the MSPLF and both options could permit the refinancing of existing debt at the time of origination (as discussed below).

II. EBITDA

We very much welcome the clarification in the updated term sheets providing that EBITDA for purposes of determining loan sizing is to be calculated on an adjusted basis. As we noted in our earlier comments, permitting adjusted EBITDA to be used will allow decisions to be made on a basis that is appropriately tailored to individual borrowers and consistent with market practice. Accordingly, we believe this clarification could significantly expand the potential reach of the program.

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3 As previously noted, a similar dilution concern would apply to the MSELF (given the same requirement for equal or senior treatment with respect to payments and security) and, to a lesser extent, to the MSNLF (where the prohibition on contractual subordination would result in existing unsecured lenders being at greater risk of dilution than existing secured lenders).

In light of the foregoing, we would appreciate confirmation of the following:

1. ***Loan Sizing Methodology***. For purposes of determining maximum potential loan size, an Eligible Lender has the flexibility to apply whichever of the permitted adjusted EBITDA methodologies it determines to be the most appropriate in the circumstances of the particular Eligible Borrower, and this may include a methodology used in an existing credit agreement or a methodology used in the Eligible Lender's internal processes.

    - The term sheets and FAQ provide that Eligible Lenders are expected to calculate adjusted EBITDA using the methodology previously used for adjusting EBITDA when extending credit to the relevant Eligible Borrower or similarly situated borrowers (in the case of the MSNLF and MSPLF) or the methodology used for adjusting EBITDA when the underlying Eligible Loan was originated or amended (in the case of the MSELF).

    - However, there may be several methodologies that an Eligible Lender uses in respect of a particular Eligible Borrower. For example, the methodology used by an Eligible Lender to calculate adjusted EBITDA for purposes of covenant compliance in an Eligible Borrower's existing debt documentation may differ from the internal methodology applied by the relevant Eligible Lender when making other decisions with respect to that Eligible Borrower or other similarly situated borrowers.

    - Similarly, an Eligible Lender may have updated the methodology that it uses to calculate adjusted EBITDA for a particular class of borrowers so that the methodology it would use for similarly situated borrowers today may be different from the methodology originally used for the relevant Eligible Borrower and so may be more appropriate in the circumstances. In the case of the MSELF, an Eligible Lender may have used one methodology at the time the underlying Eligible Loan was originated, but updated that methodology for a subsequent amendment.

    - Given these different potential EBITDA methodologies, the most efficient approach would be to permit the Eligible Lender originating the program loan to select the appropriate methodology from any of those permitted by the relevant term sheet that it currently uses, regardless of whether that methodology is included in existing credit documentation or part of the Eligible Lender's internal methodology, as it is the Eligible Lender that is in the best position to assess the needs and risks of the relevant Eligible Borrower.

2. ***Underwriting and Other Matters***. Regardless of the methodology used for determining maximum potential loan size under the program requirements, Eligible Lenders are still expected to apply their own underwriting standards when originating program loans and to use whatever adjusted EBITDA methodology they consider appropriate as part of that underwriting process even if it differs from those contemplated in the term sheets and FAQ. In addition, Eligible Lenders and Eligible Borrowers may include in program loan agreements adjusted EBITDA methodologies that differ from those contemplated in the term sheets and FAQ, so long as those methodologies are not used for determining satisfaction with program requirements, but rather for other purposes such as financial covenant compliance.

III. Tenor

We recognize that the four-year tenor for program loans contemplated by the term sheets reflects a desire to limit the risk that program loans could be structurally subordinated to earlier-maturing debt of Eligible Borrowers. However, we believe there is scope to allow for the flexibility to provide shorter-dated program loans.

There are circumstances in which shorter-dated program loans could be desirable, particularly in the context of smaller program loans. For example, if there were existing subordinated or junior debt that has a remaining tenor of less than four years, it may be appropriate for the program loan to have a tenor that matches or is shorter than the remaining tenor of that subordinated or junior debt.

Accordingly, we would recommend providing that the contemplated four-year tenor is a maximum and that shorter dated program loans are permitted so long as the amortization schedule is adjusted to reflect the reduced tenor. Making this modification to the program's contemplated terms would retain the level of protection against structural subordination currently contemplated by the term sheets while allowing greater flexibility for the program to be used in a wider range of circumstances and reducing the risk of a "maturity wall" for all program loans.

IV. MSELF Hold Requirements

We understand and support the public policy rationale underlying the provision requiring that the Eligible Lender providing a program loan continue to hold its 5% or 15% interest until the program loan matures or the SPV sells all of its participation. However, the additional provision contained in the MSELF term sheet requiring that the Eligible Lender providing an upsized tranche also continue to hold its interest in the underlying Eligible Loan is not supported by the same public policy rationale and is likely to reduce participation in the MSELF by Eligible Lenders.

Requiring an Eligible Lender to continue to hold an interest in a non-program loan is a significant restriction on the Eligible Lender's ability to manage its concentration risk by reducing its overall exposure to a particular borrower. Eligible Lenders faced with this restriction may well decide that it would be more prudent not to take on additional exposure to the Eligible Borrower and so decide not to participate in the MSELF, particularly in a circumstance in which other syndicate members are reducing their exposure. Moreover, the policy rationale for risk retention, which is to incentivize the Eligible Lender to undertake an appropriate credit assessment and apply appropriate underwriting standards, is adequately served by the requirement to retain the 5% interest in the upsized tranche. This additional requirement is thus not only inconsistent with bank safety and soundness and therefore likely to discourage participation but also superfluous.

Accordingly, we recommend that the additional MSELF hold requirement relating to the underlying Eligible Loan be removed. Additionally, we recommend that the hold requirement with respect to the retained 5% and 15% interests be made pro rata with the holding of the SPV. In other words, if the SPV sells a portion of its participation in a loan, the relevant Eligible Lender should be permitted to sell a pro rata portion of its retained interest, rather than having to wait until the SPV has sold its entire participation.

V. Debt Repayment Restrictions

Subject to one exception in the case of the MSPLF, which is discussed below, the term sheets provide that, until the relevant program loan is repaid in full, (a) Eligible Borrowers must commit to refrain from paying principal and interest on non-program debt, other than principal or interest that is "mandatory and due" and (b) each Eligible Lender must commit not to request that Eligible Borrowers pay principal or interest on non-program debt owed to that Eligible Lender, other than principal or interest that is "mandatory and due" or in the case of default or acceleration.

It seems clear that these restrictions would not prohibit the payment of regularly scheduled principal and interest or the payment of principal and interest that becomes due as a result of a default or acceleration. The FAQs also contain helpful clarifications regarding how these restrictions would relate to the use of certain lines of credit. However, we believe there are issues raised by these restrictions that require further clarification and would recommend the following:

1. ***Amendments***. These restrictions should not prohibit amendments to non-program debt that change the amortization schedule, increase the interest rate or otherwise create a new "mandatory and due" payment under that other debt, so long as such amendments are made as part of the consideration provided for an modification sought by the Eligible Borrower.

- There are many situations in which such an amendment may be appropriate. For example, if a borrower requires a waiver to avoid a breach of a financial maintenance covenant, lenders may be willing to provide that waiver only on the condition that they are adequately compensated for the additional risk, such as through an interest rate step-up or early principal repayment.

- Prohibiting amendments of this type would remove an important part of the toolkit that is used for dealing with the various situations that arise in the ordinary course of managing a loan and seriously interfere with the ability of borrowers and lenders to resolve potential defaults in a manner that avoids the need for restructuring or bankruptcy and the related collateral damage that can result for all of a borrower's stakeholders.

2. ***Contingent Payments***. These restrictions should also permit payments of principal and interest that become "mandatory and due" under non-program debt as the result of a pre-existing contractual trigger event other than default or acceleration.

    - Debt arrangements frequently provide for mandatory prepayments of principal and changes in interest rates that are contingent upon the occurrence of a trigger event, such as the receipt of asset sale proceeds or the failure to achieve a particular financial metric.

    - While some trigger events may be within the control of a borrower – for example a decision to sell assets – many such events, such as those that involve financial metrics, will depend on business performance and other factors outside a borrower's control. Prohibiting these types of payments would therefore run the risk of putting borrowers into default.

    - We would expect the restriction to still apply if there are steps a borrower can take to avoid the mandatory principal payment or interest rate change following the trigger event. For example, many debt arrangements require that asset sale proceeds be used to prepay debt, but permit borrowers to avoid that prepayment if they instead reinvest the proceeds in the business in accordance with certain specified conditions. We would also expect program loans to share pro rata in any prepayments of principal to the extent permitted by the terms of the relevant non-program debt.

3. ***Lines of Credit***. Eligible Borrowers should be permitted to continue using all revolving lines of credit in the ordinary course of business, and Eligible Lenders should be permitted to accept payments on those lines of credit.

    - There appears to be an inconsistency between the flexibility contemplated in FAQ H.3, which clarifies that an Eligible Borrower may repay lines of credit in accordance with its normal course of usage, and the equivalent statement in FAQ H.4, which states that an Eligible Lender may accept a payment on a line of credit made in the Eligible Borrower's normal course of usage, but only if that payment is a "regularly scheduled, periodic" payment.

    - While some Eligible Borrowers will have credit lines that do require regular monthly or other payments (such as credit card accounts), in many cases Eligible Borrowers will have lines of credit that permit them to carry a balance and repay and redraw from time to time in accordance with their business needs.

    - While FAQ H.3 seems to contemplate that Eligible Borrowers may make payments on this type of credit line, even if it is not a regularly scheduled payment, FAQ H.4 suggests that Eligible Lenders would not be permitted to accept such a payment. This should be clarified.

4. ***Missed Payments***. "Catch-up" payments necessary to make up for previously missed payments should constitute payments that are "mandatory and due."

   - Particularly in light of the impact of the COVID-19 pandemic, many borrowers may have missed regularly scheduled payments or been granted forbearance by lenders allowing payments to be delayed.

   - It is in the interest of all stakeholders to ensure that borrowers are permitted to make catch-up payments when they are able as this will minimize the risk of default.

5. ***Refinancing Exception***. The refinancing exception available in the case of the MSPLF should be extended to the MSNLF and MSELF.

   - We understand that the purpose of this exception is to permit Eligible Borrowers to use the proceeds of MSPLF loans to repay existing indebtedness held by parties other than the Eligible Lender providing the MSPLF loan.

   - This flexibility is valuable to Eligible Borrowers who may have been forced to obtain unusually expensive emergency financing as a result of the impact of the COVID-19 pandemic to bridge the period until funds become available under the program, and these Eligible Borrowers may wish to use the MSNLF or MSELF instead of the MSPLF.

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BPI appreciates this opportunity to comment on the updated term sheets. If you have any questions or would like to discuss any of the comments, please contact Lauren Anderson, Senior Vice President and Associate General Counsel at (202) 737-3536 (lauren.anderson@bpi.com).

Respectfully submitted,

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