PIPER | SANDLER

June 16, 2020

MSLP -- More Changes to Encourage Usage

On June 8, the Federal Reserve announced additional changes to the $600 billion Main Street Lending Program (MSLP) to encourage greater usage. The MSLP was originally introduced on April 9 as a significant component (26%) of the Federal Reserve's $2.3 trillion new and enhanced funding programs authorized by the CARES Act. On April 30, the Federal Reserve modified the original terms of the MSLP to add a third lending program and broaden the range of eligible borrowers and potential loan sizes. The most recent round of changes on June 8 demonstrate the importance of the MSLP to support medium and small businesses as mandated by the CARES Act, and the Federal Reserve's resolve to fine tune the program to encourage more usage.

The MSLP targets companies that are too large to use the Paycheck Protection Program (PPP) but too small or not qualified to issue investment grade-rated debt through the Primary Market Corporate Credit Facility (PMCCF) or the Secondary Market Corporate Credit Facility (SMCCF). PPP loans are 100% guaranteed by the SBA and include a forgiveness feature for borrowers that satisfy the PPP requirements. MSLP loans will be administered by the Federal Reserve (FRB-Boston) rather than the SBA and are not forgivable. Before launching the program, the Federal Reserve solicited comments on details including lender eligibility, borrower eligibility, differences between programs, accounting treatment, regulatory capital treatment, and program administration among others.

The Federal Reserve received over 2,200 comment letters from lenders, borrowers and other interested parties on the scope of the program along with terms and conditions. Based on these letters and other comments received, the Federal Reserve has implemented a variety of changes to broaden access to funds to a wider variety of borrowers, clarify underwriting and eligibility criteria, and simplify usage of the program.

Overall, the changes from April 9 through June 8 include:

- ***Higher Risk Borrowers Allowed***: The creation of a third Main Street program referred to as the Main Street Priority Loan Facility (MSPLF) to accommodate borrowers with higher leverage/risk profile but with the same interest rate and Eligible Lender (defined below) retained interest of 5%;
- ***Foreign Banks and Non-banks as Eligible Lenders:*** The U.S. branches or agencies of foreign banks and the U.S. intermediate holding companies of foreign banks will be Eligible Lenders and, while non-banks are not currently Eligible Lenders, the Federal Reserve is considering options to expand the list of Eligible Lenders;
- ***EBITDA Simplified and Alternative Underwriting Metrics Considered***: Borrowers will be permitted to use the definition of EBITDA in their existing loan agreements rather than the fixed definition initially provided and the Federal Reserve and Treasury will be evaluating the feasibility of allowing asset-based borrowers and non-profit organizations to borrow using alternative underwriting metrics;
- ***Smaller Loan Size Permitted***: Reduction in the minimum loan size for the MSPLF and MSNLF from $1,000,000 to $250,000 with the MSELF remaining at $10 million;
- ***Larger Borrowers Eligible***: Increase in size of eligible borrowers for the MSELF from 10,000 to 15,000 employees or from $2.5 billion to $5.0 billion in 2019 total revenue;
- ***Larger Loan Size Permitted***: Increase in maximum loan size for the MSELF from $200 million to $300 million and for the MSPLF from $25 to $50 million subject to limitations of other existing debt and leverage restrictions of 6x pro forma EBITDA. For the MSNLF, the maximum loan size increased from $25 to $35 million subject to leverage restrictions of 4x pro forma EBITDA;

Financial Services Group

Thomas W. Killian
Managing Director | Investment Banking
+1 212 466-7709
tom.killian@psc.com

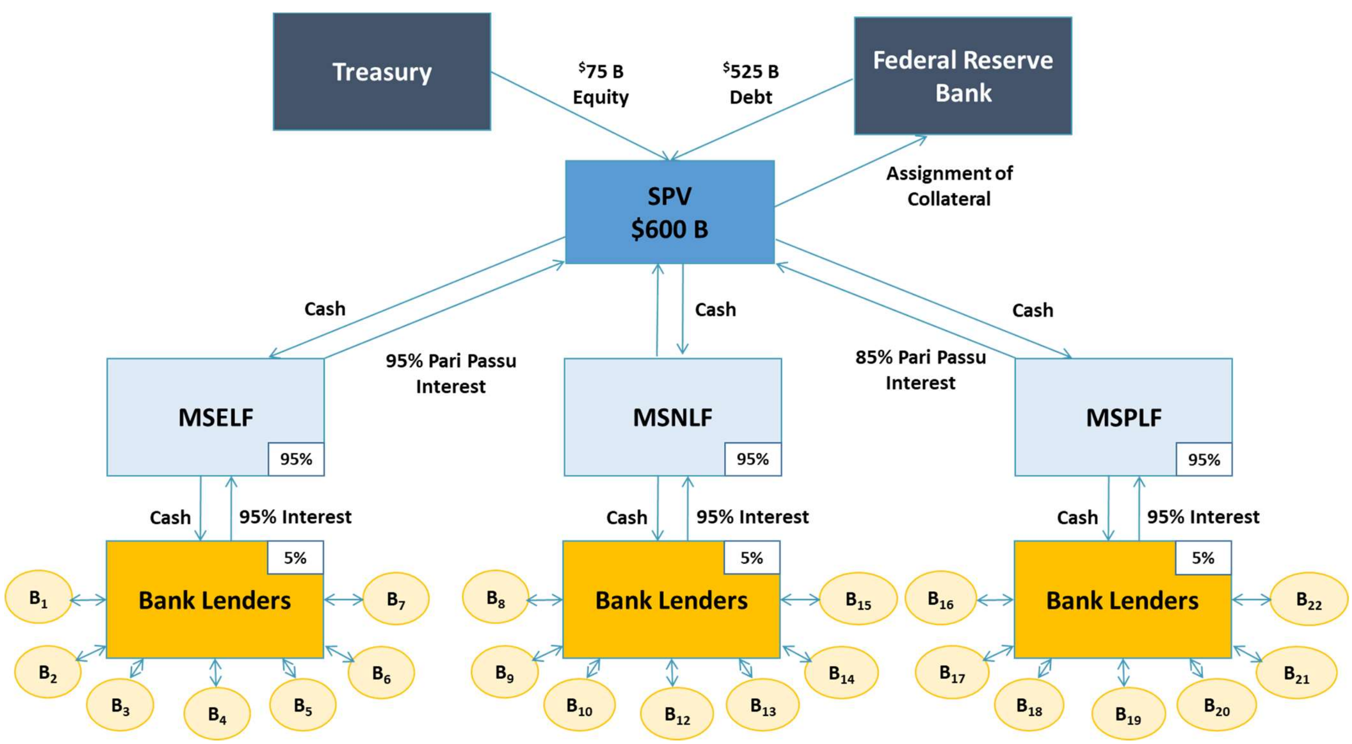
Robert Albertson
Managing Director and Chief Strategist
+1 212 466-7946
robert.albertson@psc.com

- ***Dividend Flexibility***: Greater flexibility to pay dividends and other capital distributions for a tax pass-through entity to the extent reasonably required to cover owners' tax obligations;
- ***Loan Repayment Terms Extended and Repayment Modified:*** The final maturity of all loans extended to 5 years with no principal payments due in the first 2 years and repayment of 15% in year 3, 15% in year 4 and 70% in year 5. No interest payments due in year 1 with unpaid interest capitalized; and
- ***Interest Rate Basis and Accounting Treatment Simplified***: The shift in interest rate basis for loans from SOFR to the more commonly used LIBOR and confirmation of the "true sale" treatment for all Main Street loans sold by the Eligible Lender to the Main Street SPV.

With these changes, the MSLP will now consist of three related facilities – the Main Street New Loan Facility (MSNLF), the Main Street Expanded Loan Facility (MSELF), and the Main Street Priority Lending Facility (MSPLF). This $600 billion program is intended to provide liquidity to U.S. insured depository institutions, bank holding companies, thrift holding companies, and the U.S. branches, agencies or interim bank holding companies of foreign banks (collectively referred to as Eligible Lenders) so that they can provide funding to small and mid-sized businesses. The Eligible Lenders will each be responsible for originating eligible loans (Eligible Loans) to eligible borrowers (Eligible Borrowers) that will be sold to a single common special purpose vehicle (SPV) funded by a $75 billion equity commitment from the U.S. Treasury and $525 billion in funding from the Federal Reserve Bank. In the case of the MSNLF and the MSELF, the originating Eligible Lender will retain a 5% participation in each loan sold while the SPV will own a 95% interest that it will purchase at par value. With the MSPLF, the Eligible Lender will retain a 15% participation in each loan sold while the SPV will purchase an 85% participation in the loans secured by all the assets of the SPV. The Eligible Lender and the SPV will share risk on a *pari passu* basis. As such, each Eligible Lender is strongly incented to originate loans to mid-sized business with due care as consistent with the lender's existing loan policies and procedures.

As illustrated below in Chart A, the Treasury will contribute $75 billion of equity with the Federal Reserve Bank contributing $525 billion of debt for total available funding of $600 billion. The SPV funding will be collateralized by a pledge of the loans but the Eligible Lender will only be at risk for its 5% participation in retained risk for the MSNLF and MSELF programs and 15% for the MSPLF. The Eligible Lender will be responsible for originating, underwriting and servicing the loans from borrowers described below as B1- B7.

Chart A - Main Street SPV Structure (MSNLF, MSELF, and MSPLF)



The basic borrower eligibility requirements, loan pricing, repayment terms, and servicing fees are the same for all three facilities. The MSNLF and MSPLF are designed for smaller companies with the minimum loan size of $250,000. The MSNLF is focused on lower risk/lower leverage companies with a 5% retained risk and maximum loan size limited to the lesser of $35 million or 4x pro forma EBITDA. The MSPLF targets slightly larger, higher risk/higher leverage companies with a 5% retained risk and maximum loan size limited to the lesser of $50 million or 6x pro forma EBITDA.

Chart B - Main Street Lending Program Requirements

Main Street Lending Programs (as of June 8, 2020)

Requirement	New Loans MSNLF	Priority Loans MSPLF	Expanded Loans MSELF
Min Loan Amount	$250,000	$250,000	$10,000,000
Max. Loan Amount, Lesser of:			
- Amount or	$35,000,000	$50,000,000	$300,000,000
- % Existing and Undrawn Pari Passu Debt (1) or	N/A	N/A	35.00%
- Pro Form EBITDA Muliple (2)	4x	6x	6x
Credit Facility (secured or unsecured) (3)	Term Loan	Term Loan	Term Loan/Revolver
Funding Type	New Loan	New Loan	Expanded Loans
Loan Risk Classification @12/31/19	Pass	Pass	Pass
Assessment of Borrower's Financial Condition	Required	Required	Required
Eligible Lender Retained Interest	5.00%	5.00%	5.00%
SPV Retained Interest	95.00%	95.00%	95.00%
Interest Rate (1 month or 3 month)	LIBOR + 3%	LIBOR + 3%	LIBOR + 3%
Fees (4):			
- Loan Origination (Borrower to Lender)	1.00%	1.00%	0.75%
- Servicing (p.a.)(SPV to Lender)	0.25%	0.25%	0.25%
- SPV Transaction Fee (Lender to SPV)	1.00%	1.00%	0.75%
- SPV Transaction Fee (Borrower Repay Lender)	1.00%	1.00%	0.75%
Payment Terms:			
- Final Maturity (No prepay penalty)	5 years	5 years	5 years
- Year One (No principal, unpaid int. capitalized)	$0	$0	$0
- Year Two (No principal, interest pmt. required)	$0	$0	$0
- Year Three	15.00%	15.00%	15.00%
- Year Four	15.00%	15.00%	15.00%
- Year Five	70.00%	70.00%	70.00%
Borrower Eligibility:			
- Business established before 3.13.20	YES	YES	YES
- Cannot be ineligible business (per SBA rules)	YES	YES	YES
- Employees < 15K or 2019 Revenue < $5 B	YES	YES	YES
- Must be U.S. business	YES	YES	YES
- Participate in only one MS facility or the PMCCF	YES	YES	YES
- No other CARES Act (Sub A -Title IV) support	YES	YES	YES
- Must make all required certifications	YES	YES	YES

(1) 35% of the borrower's existing outstanding and undrawn available debt that is pari passu in priority with the loan and equivalent in secured status.

(2) Amount that when added to outstanding and undrawn available debt, does not exceed the multiple of adjusted 2019 EDITDA shown in chart.

(3) For MSELF, expanded loans must have a remaining maturity of at least 18 months and be senior or pari passu with existing debt. For MSNLF and MSPLF, the loan must be senior to or pari passu in terms or priority and security to the Eligible Borrower's other loans or debt instruments, other than mortgage debt.

(4) 1% loan origination fee on the full loan amount paid by Eligible Borrower to Eligible Lender.
.25% annual servicing fee paid on the SPV purchase amount by the SPV to Eligible Lender.
.75% annual facility fee paid by Eligible Lender to the SPV on the SPV purchase amount but the Eligible Lender may require Eligible Borrower to reimburse or pay this fee.

As illustrated in Chart B above, the MSELF is designed for much larger companies with a minimum loan amount of $10 million and a maximum loan amount equal to the lesser of: (i) $300 million; (ii) 35% of the borrower's existing outstanding and undrawn available debt that is*pari passu* in priority with the loan and equivalent in secured status, or (iii) an amount that when added to outstanding and undrawn available debt does not exceed 6x pro forma EBITDA. For ease of calculation, the existing and undrawn available debt includes all amounts borrowed under the loan facility, including unsecured or secured loans from any bank, non-bank financial institution, or private lender, as well as any publicly-issued bonds or private placement facilities. It also includes all unused commitments under any loan facility calculated as of the date of loan application, but excludes all undrawn backup commercial paper lines, undrawn commitments for finance receivables, undrawn commitments that cannot be used without providing additional collateral, and undrawn commitments that are no longer available due to changes in circumstances.

The MSELF includes a SPV transaction fee of .75% payable at the time of origination by the Eligible Lender on the amount sold to the SPV. Eligible Lenders will likely require that borrowers pay this fee, resulting in no net cost to Eligible Lenders. Eligible Lenders using the MSELF will receive total fees consisting of loan origination fees of .75% on the total loan amount payable by the Eligible Borrower and .25% of the SPV participation amount payable each year by the SPV. Eligible Lenders under the MSNLF and MSPLF will have to pay a SPV transaction fee of 1.00% to the SPV at the time of origination on the amount sold to the SPV. But similar to the MSELF facility, Eligible Lenders will likely require that borrowers reimburse this fee. Eligible Lenders will receive 1.00% of the total loan amount payable by the Eligible Borrower and .25% of the amount sold to the SPV payable each year by the SPV. Please note that Eligible Borrowers can only avail themselves of one of the MSNLF, MSELF, MSPLF or the Primary Market Corporate Credit Facility (PMCCF), but Eligible Borrowers are permitted to borrow under one of the MSLP facilities in addition to the PPP program.

All MSLP facilities require that the Eligible Lender and Eligible Borrower make extensive attestations as follows:

- Eligible Lenders: attest that proceeds will not be used to repay or refinance pre-existing loans or lines of credit; will not cancel or reduce any existing lines of credit outstanding to the Eligible Borrower; certify EBITDA methodology; and certify compliance with the conflicts of interest prohibition in Section 4019(b) of the CARES Act.
- Eligible Borrowers: must attest that proceeds will not be used to repay other loans and will commit to not pay other debt (other than mandatory principal payments) of equal or lower priority until the Eligible Loan is repaid in full; attest that it will not cancel or reduce any of its outstanding lines of credit; certify that it has the ability to meet its financial obligations and will not declare bankruptcy within 90 days after closing; attest that it will follow the compensation, stock repurchase, and capital distribution restrictions under Section 4003(c)(3)(A)(ii) of the CARES Act; and certify compliance with the conflicts of interest prohibition in Section 4019(b) of the CARES Act.

Note that Eligible Borrowers were originally required to certify that they met the EBITDA leverage requirements, required financing due to the COVID-19 pandemic, and would use reasonable best efforts to maintain payroll and retain employees during the term of the eligible loan. With the April 30 overhaul, these requirements were modified. The responsibility for the calculation of EBITDA shifted from the Eligible Borrower to the Eligible Lender, who must certify that the EBITDA methodology is consistent with other credit facilities with Eligible Borrowers and current industry practice for similar borrowers. There is no requirement to certify that the financing is needed because of the COVID-19 crisis. The requirement to maintain payroll has shifted from a certification that it "will" to a representation that it "should" make commercially reasonable efforts to maintain its payroll and its employees during the time the MSLP loan is outstanding.

The Section 4003(c)(3)(A)(ii) restrictions of the CARES Act remain unchanged and are very significant. For a period until 12 months after repayment of the Eligible Borrower's loan, the borrower would be restricted from paying dividends or other distributions on common stock and, if listed, repurchasing an equity security. During this period, the Eligible Borrower must also comply with Section 4004 restrictions on employee compensation that limit the Eligible Borrower from increasing the compensation of any officer or employee whose total compensation exceeds $425,000, or from offering such employee severance pay or other benefits upon termination of employment that exceeds twice the maximum total annual compensation received by that employee until one year after the loan is no longer outstanding. Officers or employees making over $3 million last year would also be prohibited from earnings more than $3 million plus 50% of the amount their compensation last year exceeded $3 million.

A summary of certifications and covenants for lenders and borrowers is provided below in Chart C.

Chart C - Main Street Eligible Lender and Borrower Certifications

Main Street Lending Programs		
Certifications and Covenants	**Eligible Lender**	**Eligible Borrower**
Will Not Request to Repay Eligible Debt	REQUIRED	REQUIRED
Will Not Cancel or Reduce Existing Credit Lines	REQUIRED	REQUIRED
Certify EBITDA Methodology (1)	REQUIRED	N/A
Confirm No Conflict of Interest (CARES Act 4019(b)) (2)	REQUIRED	REQUIRED
Ability to Meet Financial Oblications (3)	N/A	REQUIRED
Commit to Follow CARES Act (4003(c)(3)(A)(ii)) (4)	N/A	REQUIRED

(1) Eligible Lenders must certify that the calculation of 2019 EBITDA is consistent with the methodology used for adjusting EBITDA when extending credit to the Eligible Borrower or similarly situated borrowers as of April 24, 2020.
(2) Eligible Lender and Eligible Borrower must certify that they are eligible to participate in the MSLP in light of conflicts of interest prohibitions in Section 4019(b) of the CARES Act.
(3) Eligible Borrower must certify that it has a reasonable basis to believe that it has the ability to meet its financial obligations for a least the next 90 days and does not expect to file for bankruptcy during that time.
(4) Eligible Borrower must commit to follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under Section 4003 (c)(3)(A)(ii) of the CARES Act, except that an S Corp or other pass-through entity that is an Eligible Borrower may make distributions to the extent required to make tax distributions.

The certifications required by Eligible Lenders are reasonably straightforward. The Eligible Lender will be responsible for confirming that the EBITDA methodology used to determine loan size is consistent with prior lending arrangements and industry practice. Perhaps a bigger challenge for the Eligible Lenders will be the requirement for Main Street facility debt to be senior to or *pari passu* with existing debt. There may be circumstances where borrowers are unable to provide additional collateral which may limit the amount of debt that can be provided by the Eligible Lenders.

The certifications required by Eligible Borrowers have been reduced somewhat as they will no longer be required to certify the EBITDA calculation but rather represent that they have the ability to meet their financial obligations. The extensive CARES Act Section 4003 requirements impose real restrictions on capital management and compensation. Given these significant requirements and restrictions for Eligible Borrowers, small and mid-sized business that have access to credit facilities on more commercially reasonable terms will be highly incented to pursue those arrangements. It is noteworthy that Treasury does not require an ownership interest or equity participation in the Eligible Borrower.

Summary

For small and medium-sized businesses, the Main Street Lending Program, through its MSNLF, MSELF, and MSPLF alternatives, offers a robust framework to provide liquidity and funding for new loans or increases in current credit facilities. Informed by the flood of comment letters from lenders, borrowers, and other interested parties, the Federal Reserve overhauled the MSLP effort on April 30 to add the MSPLF and expand the pool of Eligible Lenders that will provide funds to a broader group of creditworthy, small and mid-size borrowers. The challenge in completing this overhaul was to open the door to otherwise creditworthy companies that were under pressure due to the COVID-19 pandemic while avoiding problem borrowers. To accomplish this, the Federal Reserve changed the borrower requirements to exclude potential borrowers that were not “pass” credits at December 31, 2019 and exclude those borrowers who could not certify that as of the date of origination of the loan, they had the ability to meet their financial obligations for at least 90 days.

To expand the Eligible Borrower pool, the Federal Reserve has continued to make refinements to the program parameters. The Fed originally allowed for higher risk borrowers through the MSPLF but required that Eligible Lenders retain a 15% rather than 5% *pari* passu interest. On June 8, the Fed reduced this requirement to a 5% retained risk reflecting negative feedback the Fed had received on the higher risk retention for the MSPLF. The Fed decreased the minimum loan amount for MSNLF and MSPLF borrowers to $250,000 while increasing the maximum loan size allowed for the MSNLF, MSELF, and MSPLF. The loan terms were changed with no interest paid in year 1 and the loan maturity extended from 4 years to 5 years with no principal payments required for 2 years and then amortization of 15% in year 3, 15% in year 4 and 70% in year 5.

Loans originated by banks in the MSLP are underwritten based on the originating bank’s credit standards reinforced by the *pari passu* retained interest with the SPV buying such assets. The numerous requirements for attestation and limits of dividends, buybacks and compensation that come with the MSLP would likely motivate main street business borrowers instead to utilize commercially available financing if possible. Many banks that now have excess liquidity may be reluctant to become deeply involved in another government lending program with evolving standards and requirements for extensive certifications and covenants from both Eligible Lenders and Borrowers.

Time will tell whether the overhaul to the Main Street Lending Program will be successful in terms of volume of funds provided to small and mid-sized businesses and losses incurred with the programs. The Federal Reserve has continued to refine the program parameters to accommodate a wider range of potential borrowers and has hinted that it would consider lending using alternative credit metrics to accommodate asset-based businesses and non-profit organizations. This would certainly increase the volume of loans if not the credit quality.

Please note that this report is based on information as of June 15 and the funding programs referenced above are subject to further change before implementation. We have provided below a link to the Federal Reserve website with the most current information on the MSNLF, MSELP, and MSPLF term sheets and other available information.
https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm

Special thanks to Brent Layman, Director – Investment Banking, Financial Services Group for his contribution to this note.

Robert Albertson is a Managing Director and Chief Strategist in the Financial Services Group at Piper Sandler.

Previously, he was Principal and Chief Strategist of Sandler O'Neill & Partners, L.P., where he headed the investment strategy group. He provided strategy for institutional investors, consulted with clients, and worked closely with the firm's executive committee. Albertson was founder and president of Pilot Financial, a global financial sector investment fund focused on European, Latin and U.S. banks, brokers and specialty finance companies.

Albertson was director of U.S. Bank Research (1987-99) and global coordinator for financials research (1997-99) at Goldman Sachs & Co., where he led a team of analysts covering the U.S. banking industry and established initial research coverage of banks in Europe in the 1980s and several Latin American banks in the 1990s. He also spearheaded research efforts on Internet banking and the impact of technology. For a 15-year period Albertson was rated in independent surveys as one of the securities industry's premier research analysts specializing in the financial sector. Prior to Goldman Sachs & Co., he was managing director of U.S. Bank Equities Research at Smith Barney.

Albertson has been a frequent commentator on Bloomberg, CNN, CNBC, Fox Business and the Nightly Business Report and his comments have appeared in numerous print news media. He is a member of the Bretton Woods Committee, the Official Monetary and Financial Institutions Forum think tank, a former president of the Bank & Financial Analysts Association, and a regular speaker before banking industry and supervisory organizations, including the Federal Reserve Bank and the Bank for International Settlements. He is on the board of the American Financial Exchange that has produced a LIBOR alternative for banks.

Albertson holds a Master of Business Administration degree from Harvard Business School and a bachelor's degree from Carnegie-Mellon University.

Thomas W. Killian is a Managing Director in the Investment Banking Group at Piper Sandler.

Previously, he was a Principal of Sandler O'Neill & Partners, L.P. His 41-year career in commercial and investment banking includes seven years of commercial banking experience with NationsBank, structuring and arranging leveraged finance transactions; two years with Salomon Brothers, transacting capital markets and advisory assignments for a variety of major corporations; five years with J.P. Morgan, managing financial advisory and capital raising activities for banks and thrifts in the Western region of the United States; and 27 years with Sandler O'Neill, advising banks, thrifts, and insurance companies on a variety of capital markets, strategic advisory and M&A assignments.

He represented Sandler O'Neill in conferences with the Federal Financial Institutions Examinations Council, the Federal Reserve, and the Federal Deposit Insurance Corporation among others to discuss capital structure, CECL, Dodd-Frank and Basel III related issues. His articles have appeared in Bank Accounting and Finance, U.S. Banker and Modern Bankers, a publication of the Peoples Bank of China. Mr. Killian holds a Bachelor of Science from the University of North Carolina at Chapel Hill, where he was a John Motley Morehead Merit Scholar, and a Masters in Business Administration from Northwestern University's J.L. Kellogg Graduate School of Management.

General Information and Disclaimers

This report has been prepared and issued by Piper Sandler & Co., a registered broker-dealer and a member of the Financial Industry Regulatory Authority, Inc. The information contained in this report (except information regarding Piper Sandler & Co. and its affiliates) was obtained from various sources that we believe to be reliable, but we do not guarantee its accuracy or completeness. Additional information is available upon request. The information and opinions contained in this report speak only as of the date of this report and are subject to change without notice. Contact information for Piper Sandler & Co. and the author of this report is available at www.PiperSandler.com

This report has been prepared and circulated for general information only and presents the author's views of general market and economic conditions and specific industries and/or sectors. This report is not intended to and does not provide a recommendation with respect to any security. This report does not take into account the financial position or particular needs or investment objectives of any individual or entity. The investment strategies, if any, discussed in this report may not be suitable for all investors. Investors must make their own determinations of the appropriateness of an investment strategy and an investment in any particular securities based upon the legal, tax and accounting considerations applicable to such investors and their own investment objective. Investors are cautioned that statements regarding future prospects may not be realized and that past performance is not necessarily indicative of future performance.

This report does not constitute an offer, or a solicitation of an offer, to buy or sell any securities or other financial instruments, including any securities mentioned in this report. Nothing in this report constitutes or should be construed to be accounting, tax, investment or legal advice.

Neither this report, nor any portion thereof, may be reproduced or redistributed by any person for any purpose without the written consent of Piper Sandler & Co.