

## Client Alert

### Certifiable: Understanding the Certifications and Covenants of the Federal Reserve's Main Street Lending Program

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On April 30, 2020, the Board of Governors of the Federal Reserve System (the "Federal Reserve") issued revisions to the Main Street Lending Program (the "MSLP"),<sup>1</sup> which included revisions to the certifications and covenants that will be required of both Eligible Lenders ("Eligible Lenders") and Eligible Borrowers ("Eligible Borrowers") under the MSLP facilities. Below, we review these requirements and analyze what they may mean to market participants.

#### MSLP Certifications and Covenants

The MSLP consists of three separate facilities: (i) the Main Street New Loan Facility ("MSNLF"), (ii) the Main Street Priority Loan Facility ("MSPLF") and (iii) the Main Street Expanded Loan Facility ("MSELF"). While most of the required certifications and covenants are common to each of the three facilities, there are certain differences, which we outline below. In addition, these required certifications and covenants are typically not those incorporated into existing loan agreements, and the Federal Reserve has yet to provide additional guidance regarding how these certifications and covenants should be documented, as discussed in more detail below.

#### Eligible Lender Certifications and Covenants/Commitments:

Any Eligible Lender under the MSNLF, MSELF and MSPLF:

- Must commit that it will not request that the Eligible Borrower repay any debt extended by such Eligible Lender to the Eligible Borrower other than the MSNLF, MSELF or MSPLF loan ("MSLP Loans"), or pay interest on such outstanding obligations, until the MSLP Loan is repaid in full, unless the debt or interest payment is mandatory and due, or in the case of default and acceleration.
- Must commit that it will not cancel or reduce any existing committed lines of credit to the Eligible Borrower, except in an event of default.
  - With respect to the MSNLF and MSPLF, must certify that the methodology used for calculating an Eligible Borrower's 2019 adjusted earnings before interest, taxes,

<sup>1</sup> See <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200430a.htm>.

depreciation, and amortization (“EBITDA”) for the leverage requirement in Section 6(ii) of the MSNLF/MSPLF eligible loans (“Eligible Loans”) paragraph is the methodology it has previously used for adjusting EBITDA when extending credit to the Eligible Borrower or similarly situated borrowers on or before April 24, 2020, and with respect to the MSELF, must certify that the methodology used by the Eligible Lender to calculate adjusted 2019 EBITDA is the methodology it previously used for adjusting EBITDA when originating or amending the Eligible Loan on or before April 24, 2020.

- Must certify that it is eligible to participate in the applicable MSLP facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.<sup>2</sup>
- Must collect the required certifications and covenants from each Eligible Borrower at the time of origination of the MSLP Loan. Eligible Lenders may rely on an Eligible Borrower’s certifications and covenants, as well as any subsequent self-reporting by the Eligible Borrower.
- Must conduct an assessment of each potential Eligible Borrower’s financial condition at the time of application.
- Must retain a five percent holding of the MSLP Loan until it matures or the special purpose vehicle that bought the participation in the MSLP Loan sells all of its participation, whichever comes first.

### **Borrower Certifications and Covenants/Commitments:**

#### MSNLF and MSELF

Any Eligible Borrower under the MSNLF and MSELF:

- Must commit to refrain from repaying the principal balance of, or paying any interest on, any debt until the Eligible Loan is repaid in full, unless the debt or interest payment is due and mandatory.
- Must commit that it will not seek to cancel or reduce any of its committed lines of credit with the Eligible Lender or any other lender.
- Must certify that it has a reasonable basis to believe that, as of the date of the origination of the Eligible Loan and after giving effect to such loan, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period.
- Must commit that it will 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 corporation or other tax pass-through entity that is an Eligible Borrower may make distributions to the extent reasonably required to cover its owners’ tax obligations in respect of the entity’s earnings.<sup>3</sup>
- Must certify that it is eligible to participate in either the MSNLF or the MSELF, as applicable, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.<sup>4</sup>

#### MSPLF

Any Eligible Borrower under the MSPLF must make all of the required certifications, covenants and commitments applicable under the MSNLF and MSELF, except that:

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<sup>2</sup> The CARES Act was enacted as Public Law 116-136. Section 4019(b) of the CARES Act generally prohibits companies controlled by the President, the Vice President, the head of an Executive department, or a Member of Congress, as well as certain of their relatives, from receiving aid under the Treasury and Federal Reserve programs established under the CARES Act.

<sup>3</sup> These restrictions generally require a company receiving a loan to (i) refrain from engaging in stock buybacks until 12 months after the loan is no longer outstanding, (ii) refrain from paying dividends or making other capital distributions until 12 months after the loan is no longer outstanding, and (iii) comply with certain limitations on employee and officer compensation.

<sup>4</sup> See footnote 2.

- The Eligible Borrower may, at the time of origination of the MSLP Loan, refinance existing debt owed by the Eligible Borrower to a lender that is not the MSPLF lender.

### Frequently Asked Questions (“FAQs”)

The Federal Reserve has also released a set of FAQs regarding the MSLP. The FAQs address and explain several issues related to the certifications and covenants, as described below. The process by which lenders and borrowers engage with the MSLP requirements raises numerous issues concerning the consequences of a misrepresentation made in a certification or the breach of the required covenants. The guidance is clear that (i) an Eligible Lender may rely on an Eligible Borrower’s covenants and certifications, as well as any self-reporting by the Eligible Borrower and (ii) an Eligible Lender is not required to independently verify the Eligible Borrower’s certifications or actively monitor ongoing compliance with covenants required from an Eligible Borrower under the MSLP. If an Eligible Lender becomes aware that an Eligible Borrower made a material misrepresentation or otherwise breached a covenant during the term of an MSLP Loan, the Eligible Lender should notify the Federal Reserve Bank of Boston. The guidance thus far does not address the consequences of such a misrepresentation or breach as a Default or Event of Default in the loan documentation for the MSLP Loan, and is silent as to the Federal Reserve’s ability to rely on such covenants and certifications from the Eligible Borrower (either directly or as a third party beneficiary).

The guidance does state that the special purpose vehicle that is being funded by the MSLP (“MSLP SPV”) and purchasing the participations in the MSLP Loans will collect information on the certifications, covenants, lender, loan terms, and loan performance as well as the Eligible Borrower, borrower fundamentals, collateral and other characteristics. This information will be used to verify that the lender, loan, and borrower eligibility requirements have been met and support ongoing accounting and credit risk monitoring needs with respect to purchased loan participations. It is unclear if provision of this information will be a requirement on the Eligible Lender or the Eligible Borrower, and if it will be embedded in the loan documentation or the participation agreement between the MSLP SPV and Eligible Lender.

Other interesting questions regarding the documentation for the MSLP Loans include:

- It is clear that an Eligible Borrower should submit the application and any required documentation to an Eligible Lender (based on a form provided by the Federal Reserve). It is currently unclear whether the certifications and covenants in the application will be made to the Federal Reserve, or if the Federal Reserve will have the ability to rely on the covenants and certifications made by the Eligible Borrower to the Eligible Lender.
- Eligible Lenders are expected to assess each potential Eligible Borrower’s financial condition at the time of application. While implied, this does not appear to be included as a certification or covenant of the Eligible Lender.
- The term sheets require each Eligible Borrower to take “commercially reasonable” efforts to maintain payroll and retain employees in light of its capacities, the economic environment, its available resources, and the business need for labor. However, this requirement is not included as a covenant or certification that must be made by the Eligible Borrower, and it is unclear how this requirement will be incorporated in the loan documentation.

We also note that the required covenants would not prohibit an Eligible Borrower from, or Eligible Lender from accepting:

- Repayment on a line of credit (including a credit card) in accordance with the Eligible Borrower’s normal course of business usage for such line of credit,
- Incurring and paying additional debt obligations required in the normal course of business on standard terms, including inventory and equipment financing, provided that such debt is secured by newly acquired property (e.g., inventory or equipment), and, apart from such security, is of equal or lower priority than the MSLP Loan,
- Refinancing existing debt, or
- Making regularly scheduled, periodic repayments on a letter of credit in accordance with the Eligible Borrower’s normal course of business usage.

Additionally, the required covenants would not prohibit:

- An Eligible Lender from reducing or terminating uncommitted lines of credit,
- The expiration of existing lines of credit in accordance with their terms, or
- The reduction of availability under existing lines of credit in accordance with their terms due to changes in borrowing bases or reserves in asset-based or similar structures.

However, a typical loan agreement would typically regulate the incurrence of additional debt and permitted refinancings of outstanding debt, as well as the prepayment of “junior debt” (which would typically be limited to contractually subordinated debt and, depending on the loan facility, junior secured and unsecured debt).

### Issues Raised by the MSLP Certifications and Covenants

- Who can rely on the MSLP certifications and covenants?
  - Typical covenants in a typical loan agreement are made by the borrowers to the lenders and agents, and lenders typically do not make representations to the borrowers and make few (if any) representations to other lenders. While it is unclear under existing guidance, it appears that the required MSLP certifications and covenants that must be made by Eligible Lenders would be made to the Federal Reserve. Additionally, while the FAQs provide that an Eligible Lender is responsible for collecting the required certifications and covenants from each Eligible Borrower at the time of origination or upsizing of an MSLP Loan, and may rely on them, Eligible Lenders are not responsible for independently verifying that information. If there is a breach (especially one by the Eligible Borrower), will the Eligible Lender be able to enforce that breach?
- How are the MSLP certifications and covenants meant to be documented?
  - An MSLP Loan under the MSPLF appears to be a loan that will be separately documented in its own loan agreement and will be potentially subject to an intercreditor agreement with the Eligible Borrower’s other loans or debt instruments (other than mortgage debt) in order to achieve the senior or pari passu ranking required by the MSPLF terms. The MSNLF similarly appears to be a loan that will be separately documented in its own loan agreement and is only required to not be contractually subordinated to the Eligible Borrower’s other loans or debt instruments. In these cases, are the certifications and covenants of the Eligible Borrower meant to be included in the new MSPLF or MSNLF loan agreement such that misrepresentation or breach is a potential event of default that could potentially cross-default the company’s other loans or debt instruments?
  - The MSELF is a term loan that is an “upsized tranche” or “new increment” of a previously existing term loan or revolving credit facility, and the FAQs expressly contemplate that a MSELF term loan will be part of a multi-lender facility, which may include lenders that are not Eligible Lenders.<sup>5</sup> In this case, close care needs to be taken to understand the consequences of embedding such certifications and covenants of the Eligible Borrower in the loan agreement (either by amendment or through an incremental joinder or amendment), because in a typical loan agreement, the non-Eligible Lenders, who likely constitute the “Required Lenders,” could be given the rights to waive or enforce defaults or events of default related to the breach or misrepresentation of the required MSELF certifications and covenants. In order to avoid this result, such certifications and covenants of the Eligible Borrower could potentially be embedded in an engagement letter, commitment letter or other letter agreement that does not constitute a loan document in order to avoid this default scenario, with the only remedy potentially being breach of contract.
  - The guidance is also unclear about how the certifications and covenants of the Eligible Lender would be documented and the potential consequences of breach desired by the Federal Reserve. Presumably such certifications and covenants will be added to the forthcoming form of participation agreement being drafted by the Federal Reserve (and

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<sup>5</sup> FAQ D.3.

not the loan documentation). It would be a surprising outcome, however, if the Federal Reserve expected such certification and covenant of an Eligible Lender to be made for the benefit of the Eligible Borrower, but if so, what would be the Eligible Borrower's remedy?

- What are the differences among certifications, covenants and commitments?
  - The MSLP facilities use the terms somewhat interchangeably. The term sheet headings refer to “Certifications and Covenants” for both lenders and borrowers. The guidance appears to structure these undertakings so that the parties will make the certifications when a borrowing occurs, and then covenant to maintain certain factual statuses throughout the life of the loan. It is unclear whether these different terms apply to different obligations.
    - The term sheet uses the term “commit” to describe certain actions that the parties must take, including forbearing to request repayments or cancelling or reducing lines of credit.
    - It uses the term “certify” to refer to steps taken to determine eligibility to participate in the MSLP.

### **Certifications Under the Secondary Market Corporate Credit Facility (“SMCCF”)**

While there are still numerous open questions regarding the certification process under the MSLP, it may be useful to review how the Federal Reserve has handled the certifications it has required under a separate facility meant to aid corporate borrowers. In particular, on May 5, 2020, the Federal Reserve Bank of New York (“FRBNY”) released the seller certification packet for the SMCCF, a facility which will purchase securities through an SPV (“SMCCF SPV”) from certain eligible sellers in the secondary market.<sup>6</sup> While issued in respect of a different facility, these documents offer clues as to how the Federal Reserve may interpret certification issues with respect to the MSLP. Below, we outline the materials in the packet:

- Sellers must certify the following to be an Eligible Seller:
  - The Seller is solvent;
  - The Seller is a U.S. Business, as defined in Section 4003(c)(3)(C) of the CARES Act;<sup>7</sup> and
  - The Seller satisfies the conflict of interest requirements, as detailed in Section 4019 of the CARES Act.
- Sellers must also agree to a verification mechanism for the above U.S. business and conflict of interest requirements.
- Sellers must review and complete the seller certification packet and provide a signed version of the materials via pdf to the FRBNY via email beginning after May 6, 2020. The FRBNY will confirm receipt prior to the FRBNY purchasing the securities from the Eligible Sellers.

### **Notes About the SMCCF Seller Certification Packet:**

- Each certification is separate, and is made by the Seller to the Federal Reserve, the FRBNY, the Secretary of the Treasury and the SMCCF SPV.
  - Certifications are made by the chief executive officer (“CEO”) or an authorized corporate officer of the Seller.

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<sup>6</sup> See <https://www.newyorkfed.org/markets/secondary-market-corporate-credit-facility/secondary-market-corporate-credit-facility-seller-certification>.

<sup>7</sup> Section 4003(c)(3)(C) of the CARES Act defines United States businesses as businesses “that are created or organized in the United States or under the laws of the United States and that have significant operations in and a majority of its employees based in the United States.”

- If the certification information changes, the Seller must immediately notify the FRBNY.
- If a certification includes a knowing material misrepresentation, the Federal Reserve or the FRBNY will promptly refer the matter to appropriate law enforcement personnel for action under applicable criminal or civil law.
- The U.S. business certification must be made no later than the date on which the SMCCF SPV makes a purchase from the Seller. If the U.S. business status changes, the Seller must immediately notify the FRBNY and stop sales. This certification (as well as the other certifications, presumably) ends on September 30, 2020, or when SMCCF ends. It must be signed by the CEO and the chief financial officer (“CFO”) of the Seller.
- The conflict of interest certification requires the Seller to do “reasonable diligence” of potential conflicts of interest as outlined in the certification. It must be signed by the CEO and CFO of the Seller and each must acknowledge that in the case of any knowing and willful misrepresentation or omission of a material fact, the Federal Reserve, the FRBNY or the Secretary of Treasury “that is providing the SMCCF” may refer the matter to the relevant law enforcement authorities for investigation and possible action in accordance with applicable law (the certification cites 18 U.S.C. § 1001 and 31 U.S.C. §3729). This certification is based on the Seller’s “good faith” belief in the facts required to comply with Section 4019(c) of the CARES Section.
- **Verification requirements.** These are requirements to verify and support the bases on which the Seller made the above certifications for CARES Act on U.S. businesses and conflict of interest. For those certifications, a Seller agrees to maintain records containing the bases for the certifications and agrees to make it available to the FRBNY as promptly as is practicable upon request or substitute an attestation by an auditor that has examined the appropriate files. Sellers are required to retain files for 20 years following the end of SMCCF. The verification must be signed by the CEO and CFO of the Seller.

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