Chapman and Cutler LLP

Chapman Client Alert

July 7, 2020 Current Issues Relevant to Our Clients

For Lenders – Navigating Main Street Loan Considerations

The Federal Reserve has established the Main Street Loan Program to provide support to small and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 pandemic.[1] To facilitate the program, the Treasury Department has made a one-time $75 billion investment in a special purpose vehicle (the "***SPV***"), which will use the funds to buy participations in loans made by Eligible Lenders to Eligible Borrowers.[2]

We have fielded many questions from lenders regarding the nuances of the Main Street program, and are aware that, among banks, there is still some level of uncertainty regarding (i) how lenders should underwrite Main Street loans, (ii) how the participation structure works, particularly with respect to legal lending limits, and (iii) how federal and state banking regulators are likely to view Main Street loans when conducting their regular examinations.

Executive Summary

In short, the Program Documents, when read together with the Supervisory Guidance, (i) ask Eligible Lenders to underwrite Main Street loans using the same criteria they would use for any other loan in their portfolio, (ii) provide comfort to Eligible Lenders around contingent funding and legal lending limits, and (iii) give direction to bank regulators to consider the Main Street loans made by Eligible Lenders in the context of loans having been made in the context of a "major disaster." As the Main Street program evolves, we will continue to monitor developments in these important areas. Any clients with specific questions regarding these topics, or the Main Street program generally, are encouraged to reach out to the authors of this client alert or their regular Chapman attorneys for more information.

Analysis

I. Underwriting and Documentation

Main Street Program loans are intended to help businesses that were healthy prior to the pandemic, but that are experiencing financial challenges as a result of COVID-19. The Program Documents require Eligible Lenders to assess each potential borrower's financial condition at the time of such borrower's application, and to apply their own underwriting standards in determining whether, and on what terms (other than those prescribed by the Program Documents), to make a Main Street loan.

There are no reduced or special underwriting standards for Main Street loans – the Program Documents are clear that the Eligible Lender should apply its own current and customary underwriting standards that it would apply to a loan made outside of the Main Street program to any borrower in the same industry, and that the Eligible Lender has the *sole authority* to make all credit decisions with respect to the Main Street program, subject only to those specific areas where the program sets maximum and minimum eligibility requirements (e.g., maximum loan size, minimum financial reporting etc.). The Federal Reserve does not expect or require an Eligible Lender to accept credit risk that it would not normally take, or conversely, to decline loans that it would otherwise approve. However, the Program Documents also do not prevent an Eligible Lender from *voluntarily and prudently* modifying its existing, customary underwriting standards to better accommodate prospective Main Street borrowers in light of the COVID-19 pandemic and the purpose of the Main Street program, but any such underwriting modifications could be subject to regulatory scrutiny, as discussed below.

Unlike the Paycheck Protection Program, there is no "standard form loan agreement" for Main Street program loans. Instead, Eligible Lenders are instructed to use legal documents that are substantially similar to what they would use in an ordinary loan transaction, with the addition of certain provisions and covenants required by the Main Street program. The specifically required Main Street provisions are described in detail in each respective term sheet and in Appendices A and B of the FAQs.

II. Participation Structure Mechanics – Timing of Funding and Legal Lending Limits

Eligible Lenders retain only a 5% interest in the Main Street loan, with the other 95% being sold as a participation to the SPV. The FAQs have recently been updated to (i) permit an Eligible Lender to make a Main Street loan contingent on a binding commitment from the SPV to purchase a participation, and (ii) acknowledge that the SPV will typically fund its participation within one business day of delivering a binding commitment. With respect to concerns around violating legal lending limits, the FAQs state that if the Main Street loan is funded on a contingent basis, only the 5% retained interest will count towards the Eligible Lender's lending limit so long as the SPV participation is closed within one business day after funding by the Eligible Lender. Additionally, if it takes more than one day to close the participation such that the *full amount* of the Main Street loan is treated, technically, as a loan made to the borrower and would result in a breach of the legal lending limits, such breach will not be treated as a violation so long as the delay in funding was outside the Eligible Lender's control.

III. Evaluation by Federal and State Regulators

For banks seeking additional guidance on how federal and state regulators will evaluate Main Street loans, the Program Documents direct Eligible Lenders to the Major Disaster Guidance, which addresses supervisory practices to be considered and applied by regulators in connection with examining financial institutions that are directly affected by a "major disaster." Under the Major Disaster Guidance, examiners are instructed to consider the bank's ability to identify affected loans and investments, to determine the appropriateness of underwriting standards (including legitimate reasons for easing such standards), and generally to not criticize financial institutions for taking steps to help impacted borrowers, such as through modified underwriting standards, even if the resulting loans have weaknesses that result in adverse credit classification.

Additionally, on June 24, 2020, federal and state bank regulators released the Pandemic Guidance, which is generally consistent with the Major Disaster Guidance and instructs examiners to "consider the unique, evolving, and potentially long-term nature of the issues confronting institutions [as a result of the COVID-19 pandemic] and exercise appropriate flexibility in their supervisory response."

Taken together, the Supervisory Guidance indicates that regulators should not unduly criticize reasonable assistive measures undertaken by financial institutions in light of recent economic circumstances, while nevertheless maintaining the basic principles and standards of loan portfolio evaluation.

For More Information

We continue to monitor the Main Street program as it evolves, and we are actively working with several clients interested in either accessing funding or participating as a lender under the program. Any potential lenders interested in discussing the nuances of participating in the Main Street program should reach out to the following authors of this client alert or their primary Chapman attorneys.

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1 The analysis in this article is based on the Main Street Loan Program term sheets, the related Frequently Asked Questions document (dated as of June 8, 2020), (the "**FAQs**" and together with the term sheets, the "**Program Documents**"), each available for download from the www.bostonfed.org website as of the date of this article, the Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions (June 2020) (the "**Pandemic Guidance**"), and the Interagency Supervisory Examiner Guidance for Institutions Affected by a Major Disaster (December 2017) referenced in FAQs (the

"**Major Disaster Guidance**," and, together with the Pandemic Guidance, the "**Supervisory Guidance**"). The considered views expressed herein are qualified and limited in their entirety by the Program Documents available as of the date hereof and the Supervisory Guidance.

2 Capitalized terms used but not defined herein have the meanings given to them in the Program Documents.

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