The Main Street Lending Program—Avoiding the Potholes on the Road to Recovery

This article is co-authored by Pillsbury and Guidehouse.

Craig Saperstein, Joel Simon, and Deb Thoren-Peden with Alma Angotti (Guidehouse) and Jay Perlman (Guidehouse)

EXECUTIVE SUMMARY

- The Federal Reserve's Main Street Lending Program (Program) will make approximately $600 billion in financing available for businesses with up to 15,000 employees or $5 billion in 2019 revenues.
- As with other COVID-19 relief programs, participation in the Program brings with it scrutiny from regulators, prosecutors, Congressional committees, the private bar and the media to prevent fraud, waste and abuse of these funds.
- Program participants should: (i) carefully document the elements proving loan eligibility; (ii) work carefully with their attorneys, accountants, and lender to ensure the accuracy of applications, certifications and reporting; (iii) refrain from engaging in transactions or unwarranted accounting changes that subvert, or have the appearance of subverting, the objectives of the Program; and (iv) establish a crisis management plan, covering legal response and government and public relations, for handling a potential congressional or agency investigation into their Main Street loans.

Introduction

Under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Congress authorized the Treasury Department to provide more than $450 billion for loans, loan guarantees, and investments in support of the Federal Reserve's lending facilities.

In April, Treasury and the Federal Reserve took their first steps toward operationalizing these lending facilities by announcing the establishment of the Program, releasing abbreviated term sheets and a preliminary FAQ outlining basic details and elaborating on several key points regarding the loans available under the Program. In late May, the Federal Reserve issued a substantially revised and enhanced FAQ, together with a suite of required documents, checklists and model language for certain required loan provisions. In early June, the Federal Reserve further expanded and enhanced the Program, issued a further revised FAQ and amended most of the form documents it issued in late May. The Program has opened for lender registration and the Federal Reserve has encouraged lenders to begin lending immediately. As as the case with the Small Business Administration's Payroll Protection Program (PPP), it is possible that refinements or further revisions could be forthcoming during the tenure of the Program. The Federal Reserve has also released term sheets for public comment for Main Street Loans for nonprofit organizations.

The Program establishes three new loan facilities: (1) the Main Street **New** Loan Facility (**MSNLF**), (2) the Main Street **Priority** Loan Facility (**MSPLF**) and (3) the Main Street **Expanded** Loan Facility (**MSELF**). All three facilities will enable lending to businesses by eligible lenders (generally, an insured depository institution). Under all three facilities, the Federal Reserve Bank of Boston will commit to lend to a single purpose vehicle (SPV), and Treasury will use $75 billion in CARES Act funds to make an equity investment in the SPV. The SPV will then purchase 95% participations in each eligible

loan from the eligible lender under the loan facilities, with the eligible lender retaining 5% of the all three facilities. The SPV will purchase participations in these loans until September 30, 2020, unless the Federal Reserve and Treasury extend the facilities.

Businesses with up to 15,000 employees or $5 billion in 2019 revenues are eligible to participate in the Program.[1] In addition, businesses seeking loans under the Program must be organized in the United States or under U.S. law, and have significant operations and a majority of their employees based in the U.S. At present, however, there is no limit on foreign ownership of an applicant. Although the recipient can be a borrower of a PPP loan or a Small Business Administration Economic Injury Disaster loan, it cannot have received specific support pursuant to the Coronavirus Economic Stabilization Act of 2020 (Subtitle A of Title IV of the CARES Act). Additionally, if the recipient is a borrower under one of the Program facilities, it cannot borrow under any of the other facilities or the Primary Market Corporate Credit Facility (a separate program primarily for investment grade companies).

Certain Loan Requirements and Restrictions; Borrower Certifications and Covenants[2]

- Borrowers must certify as to meeting various eligibility criteria for obtaining a Program loan, including as to formation, maximum number of employees, maximum annual revenue, being a U.S. business and other matters;
- Borrowers should make commercially reasonable efforts to maintain their payroll and retain employees during the time the eligible loan or, in the case of the MSELF loan, the upsized tranche, is outstanding. Borrowers that have already laid off or furloughed workers are still eligible;
- Borrowers must commit to refrain from repaying other loan balances until the eligible loan, or in the case of the MSELF, the upsized tranche is repaid in full (except for mandatory payment obligations, ordinary course repayments of lines of credit, refinancing debt that is maturing no later than 90 days from the date of the refinancing and, in the case of the MSPLF, refinancing of debt owed to other lenders);
- Borrowers must certify that they will not seek to cancel or reduce any of their outstanding lines of credit;
- Borrowers must certify that they have a reasonable basis to believe that on a pro forma basis they have the ability to meet their financial obligations for at least the next 90 days and do not expect to file for bankruptcy during this period;
- Borrowers must certify that they are unable to secure adequate credit accommodations from other banking institutions;
- Borrowers must certify as to required deliverable financial information;
- In the case of the MSNLF and the MSELF, Borrowers must certify as to certain matters relating to the secured or unsecured status and relative priority of the Main Street loans and any security vis-à-vis other debt of the Borrowers;
- If a Borrower is a subsidiary of a foreign company, the Borrower must commit to using the proceeds of the Program loan for the benefit of the Borrower, its consolidated subsidiaries and other affiliates of the Borrower;
- If a Borrower is a holding company, the Program loan must be guaranteed on a joint and several basis by its subsidiaries;
- Borrowers may not buy back any of their own or their parent company's equity securities that are listed on a national securities exchange, subject to certain limited exceptions;
- Borrowers may not pay any dividends or make other capital distributions (other than tax-distributions for pass-through entities) for 12 months following repayment of the loan;
- Borrowers may not increase compensation for employees making more than $425,000 and must comply with other limits on employee compensation;
- Borrowers' certifications and covenants shall also include an indemnity in favor of the beneficiaries of the certifications and covenants in the event they are breached; and
- Borrowers will be required to notify the lender of their Program loan of any material misrepresentation with respect to any certification and of any material breach of a covenant during the time the Program loan is outstanding.

---

1 Notably, the program announcement did not specify a minimum number of employees that a business must employ in order to be eligible.

2 Borrowers and lenders interested in participating in the Main Street Lending Program should carefully review the information, term sheets, FAQ and documents available on the Federal Reserve's website and the Federal Reserve Bank of Boston's website before participating in the Program.

Stimulus Oversight

As with the Troubled Asset Relief Program (TARP), the CARES Act establishes a number of oversight bodies to ensure that both the Administration and the recipients of federal funds (or federally backed funds) comply with the law and avoid waste/fraud/abuse. For the Executive Branch, the CARES Act authorizes the appointment of a Special Inspector General for Pandemic Recovery as well as a Pandemic Response Accountability Committee consisting of a panel of agency inspectors general, both of which will monitor use of relief funds, investigate potential fraud, waste and abuse, and potentially claw back improperly used relief funds. In fact, more than $250 million has been allocated to fund inspectors general oversight of CARES Act spending.

In addition, the Attorney General and Deputy Attorney General have directed United States Attorneys' offices to "prioritize the investigation and prosecution of coronavirus-related fraud schemes … and appoint a Coronavirus Fraud Coordinator to serve as the legal counsel for the federal judicial district on matters relating to the coronavirus, direct the prosecution of coronavirus-related crimes, and to conduct outreach and awareness." This directive has resulted in the announcement of cases alleging price gouging and fraud.

Congress will also be conducting oversight with respect to federal spending in response to the pandemic. In addition to the existing committees that will exercise jurisdiction (i.e., House Energy and Commerce, Appropriations, Financial Services) the CARES Act establishes a Congressional Oversight Commission—whose members are appointed by congressional leadership—to oversee the Treasury and Federal Reserve's economic relief activities. On May 18, that commission issued its first report—focusing on the $500 billion the CARES Act allocated to the Treasury (which included the funds earmarked for the Program) to help support and stabilize the economy. That report included a number of questions about the operation and oversight of the Program. Additionally, in late April, the House created a Select Subcommittee on the Coronavirus Crisis within the larger House Committee on Oversight and Reform. This subcommittee will scrutinize alleged abuses in spending of federal coronavirus relief funds and has already begun investigating several companies who have received federal financing under the CARES Act.

In addition to oversight and investigation issues, there will be public reporting of loan acceptance (and the potential embarrassment/shaming of recipients to return loans as was seen in the case for certain PPP loans), which includes securities law filings for public companies, Freedom of Information Act requests and disclosure of Employer Identification Numbers.

Program participants would be well served to ensure that they have plans in place to handle and react to any investigation by either an Executive Branch or congressional body into their disbursement and spending of such funds, as well as any negative publicity resulting from those investigations or in some cases merely applying for or borrowing a loan under the Program. In particular, these organizations should develop crisis management plans geared toward these types of investigations and should, via government affairs representatives, develop relationships with key lawmakers who would be willing to protect and promote their interests in the event of inquiries from Congress. These considerations are in addition to any potential liability a borrower may have for any material misrepresentations in connection with the certifications or any material breach of the covenants made by it under a Main Street loan (including pursuant to the indemnity it provides to the beneficiaries of those certifications and covenants).

Mitigating the Risk and Preparing for Oversight

Program participants might be well served to look to the regulatory activity and media attention surrounding the PPP when considering the steps they should take to mitigate potential fraud and other compliance and reputational risks and prepare for the inevitable oversight requests

To guard against fraud, waste and abuse, organizations should make sure they have implemented a system of controls built on a framework of **prevention**—the first line of defense to protecting your organization; **detection**—assessing whether your preventive controls are effective; and **remediation**—addressing weaknesses uncovered during the detection phase or otherwise, designed to identify and monitor for potential fraud and remediate program vulnerabilities in the following areas:

A. Management of Internal Risk

Conducting an assessment and, where necessary, enhancing the controls they have in place to manage

relief funds processes are important first steps to effective relief funds management. Borrowers should document their use of loan proceeds to ensure that they are being used for permissible purposes and not for the improper repayment of other loan balances, payment of dividends or profit distributions, or improper executive compensation.

B. Financial Controls
Well-designed and executed financial controls guard against fraud, waste, and abuse. They protect the integrity of the accounting and reporting of relief funds and promote management accountability of how the funds are spent.

An effective financial controls environment should include appropriate segregation of duties in regard to procurement, payment processing, recordkeeping and reporting.

C. Documentation and Reporting
Lenders should have detailed and timely documentation describing the lending process and the business decisions they made to prioritize customers. They should also create detailed reporting to identify potential fair lending, discrimination, and other risks. Relief funds recipients are required to maintain appropriate records and to be able to produce supporting documentation of the disposition of the funds. Borrowers should be prepared to be subject to an audit where the government will dig deep into their financial records and systems to find supporting documentation for expenditures.

D. Quality Assurance/Quality Control (QA/QC)
Program participants should conduct regular testing, comprehensive reviews, and risk-based analytics to detect, identify and protect against the mismanagement of relief funds and intentional efforts to circumvent established controls. Lenders and borrowers should be hyper-focused on performing QA/QC to review amounts and calculations to protect themselves and their borrowers. Lenders should review loans to verify that employees followed lending procedures, including reasonably relying on borrower attestations and reviewing the amounts and calculations.

E. Internal Audit and Investigations
A robust internal audit process will help identify and remediate any potential anomalies or control weaknesses. In addition, a robust investigation process can help organizations effectively address indicators or allegations of illegal or unethical conduct.

F. Regulatory Change Management
Given the newness of the Program, regulatory guidance is being issued at a frenetic pace. As such, Program participants should implement a regulatory change management process that can capture, analyze, summarize, and communicate regulatory changes, guidance, and directives to relevant stakeholders. This process will help ensure accurate reporting of use of relief funds.

Partnering to Protect Clients in Times of Crises

Pillsbury and Guidehouse are uniquely positioned to help organizations ensure that they have the proper control environment relating to the application for and use of relief funds.

Pillsbury's team combines extensive industry knowledge, legal and regulatory experience, and investigation skill to provide comprehensive service to a wide range of clients who may be beneficiaries of Program funding, and our **COVID-19 Response Team** has been leading the legal industry in providing critical guidance to clients during this urgent and quickly evolving crisis.

Guidehouse has a long history of providing consulting and advisory services to the financial services industry and as well significant experience helping clients develop, document, operationalize, and implement controls to demonstrate prudent use of government funds in response to various natural and manmade disasters, including 9/11, the 2008 financial crisis, and Superstorm Sandy.

Pillsbury

Craig Saperstein, Partner
+1.202.663.9244
craig.saperstein@pillsburylaw.com

Joel Simon, Partner
+1.212.858.1094
joel.simon@pillsburylaw.com

Deb Thoren-Peden, Partner
+1.213.488.7320
deborah.thorenpeden@pillsburylaw.com

Guidehouse

Alma Angotti, Partner
+1.202.481.8398
alma.angotti@guidehouse.com

Jay Perlman, Director
+1.202.973.3220
jay.perlman@guidehouse.com