CARES Act Economic Assistance to Business Enterprises, States and Municipalities

Executive Summary of Economic Assistance to Businesses

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 (the "Act"), a massive federal stimulus package that provides more than US$2 trillion in economic relief.

The CARES Act establishes several new programs aimed at ensuring liquidity for businesses small and large. The Act addresses small business liquidity needs through Small Business Administration (SBA) programs described in a separate Squire Patton Boggs analysis. It also authorizes the Treasury Department to provide up to US$46 billion in direct loans, loan guarantees, and other investments to air carriers and national security firms. Moreover, the Treasury Department is authorized to provide up to US$454 billion in funding to the Federal Reserve Board ("Federal Reserve"), which will provide financial assistance to businesses and State and local governments with liquidity needs as a result of the COVID-19 pandemic. The Federal Reserve will be able to leverage these funds on what we believe will likely be a 10:1 ratio, thereby injecting more than US$4 trillion in liquidity into financial markets and businesses. One of the programs specifically identified in the Act – the Main Street Lending Program – would be for businesses that have between 500 and 10,000 employees. Notably, the Federal Reserve had previously announced that it will establish a facility – separate from the facility contemplated by the Act – aimed at supporting small and mid-sized businesses.

The funds provided by the Act will provide much needed financial support to businesses of all sizes during this period of economic uncertainty. Importantly, the Federal Reserve is likely to utilize commercial banks to originate and service its credit facilities. This should accelerate the delivery of needed credit to businesses. We discuss below the eligibility requirements and outline key considerations – which differ for each of the aforementioned programs – that will be top of mind in examining the feasibility and costs, economic and otherwise, of obtaining such relief.

Treasury Direct Lending Program

Overview

The Act authorizes the Secretary of the Treasury to provide up to US$46 billion of direct loans, loan guarantees, and other investments to certain essential businesses, including:

- US$25 billion for passenger air carriers, businesses that inspect, repair, and maintain aircraft, and ticket agents;
- US$4 billion for cargo air carriers; and
- US$17 billion for businesses that are "critical to maintaining national security".

In addition, as discussed below, the Act makes US$454 billion available to the Treasury Department to make loans and loan guarantees to, and other investments in, programs or facilities established by the Federal Reserve. This funding will likely serve as a first loss guarantee for the programs that the Federal Reserve establishes. Since Treasury's capital is expected to stand in the first loss position, the Federal Reserve will be able to leverage this funding, and it is widely expected that the leverage will be at levels of up to 10:1. That would enable the Federal Reserve to provide over US$4 trillion in support to businesses and State and local governments by making and/or purchasing loans and purchasing the debt securities of issuers directly or in the secondary market.

Eligibility

To be eligible for a direct loan, loan guarantee, or investment from the Treasury Department, the Treasury Secretary must determine that an air carrier or national security firm meets the following conditions:

- Alternative financing is not reasonably available for the company;
- The loan or loan guarantee is secured or made at an interest rate that reflects the risk of the loan;
- The duration of the loan or loan guarantee is as short as possible and not more than 5 years;
- The company and any affiliate will not engage in stock buybacks until 12 months after the loan or loan guarantee is no longer outstanding, except to the extent required by contract in effect as of the date of enactment;
- The company will not pay dividends on common stock until 12 months after the loan or loan guarantee is no longer outstanding;
- The company will maintain the employment level that existed on March 24, 2020 to the extent practicable until September 30, 2020, and in any case will not reduce its employment level by more than 10-percent of the level that existed on March 24, 2020; and
- The company is organized in the US, has significant operations in the US, and has a majority of its employees in the US.

From a business standpoint, the restrictions on paying dividends and stock buybacks may well result in investors avoiding further investments in those sectors that are subject to these prohibitions, which could potentially make these businesses more reliant on the government for financial support.

Also, in order to offer financial protection to the federal government, the Treasury Department must receive a warrant, an equity interest, or a senior debt instrument that the Treasury Secretary – in his sole discretion – deems to be appropriate.

Another issue that is determined at the discretion of the Treasury Secretary is the appropriate interest rate based on the risk of the loan or loan guarantee. Under existing regulatory authority, the Treasury Department may make a determination as to the types and valuation of acceptable collateral. Pursuant to the Act, the interest rate must reflect the risk of the loan and, to the extent "practicable," not be less than an interest rate based on market conditions for comparable obligations prevalent prior to the outbreak of the COVID-19 pandemic.

Another condition that comes along with a loan or loan guarantee from the Treasury Department: annual compensation limits for officers and employees until 12 months after the loan ceases to be outstanding. The Act prohibits recipients of any direct lending through Treasury from increasing the compensation of any officer or employee whose total compensation in 2019 exceeded US$425,000, or from providing severance pay or other benefits upon termination of employment of more than twice the maximum total annual compensation received by that employee, until one year after the loan is no longer outstanding. Additionally, officers or employees who were paid over US$3 million in 2019 could not be paid more than US$3 million plus 50-percent of the amount their compensation in 2019 that exceeded US$3 million. Beyond the impact this restriction on compensation will have on the most senior-level executives, another practical implication is the potential negative impact this will have on a company's ability to attract employees at the second and third levels of the organization.

Application and Other Procedures

We expect that the Treasury Department will soon issue detailed guidance on the process to apply for direct loans, guarantees, or investments. Indeed, even as this alert is published, Senate Banking Committee Chairman Mike Crapo (R-ID) has sent a letter to Treasury Secretary Steven Mnuchin and Federal Reserve Chairman Jerome Powell seeking clarity on many of the issues we identify and calling for the expedient issuance of "widely-available guidance and FAQs to the marketplace about how the [financial assistance] will work; terms and conditions for eligible issuers, assets, and collateral; guidance on waivers; and a point of contact or inquiry portal." From our perspective, the politics surrounding this program suggest that the application and approval process likely will be quite intensive and public facing.

Given the urgency in the economy for liquidity, and the lack of capacity for Treasury and the Federal Reserve to process review and fulfill the sheer volume of requests for assistance that are anticipated, both Treasury and the Federal Reserve will need assistance from private sector companies to implement these programs in an expedited manner. However, due to oversight interests by the Congress, the Act establishes within the Treasury Department an Office of the Special Inspector General for Pandemic Recovery, which will conduct, supervise, and coordinate audits and investigations of the financial assistance provided by the Treasury Secretary. The Special Inspector General is required to provide quarterly updates to Congress that provide the details of all such financial assistance.

Additionally, the Act establishes a Congressional Oversight Commission ("Commission") charged with oversight of the Treasury Department and the Federal Reserve in their efforts to provide economic stability in the face of the ongoing and evolving threats stemming from the COVID-19 pandemic. As part of its oversight efforts, this Commission is authorized to secure from any federal department or agency information it deems necessary to carry out its oversight responsibilities. Moreover, the Commission must submit reports to Congress every 30 days specifying:

- The impact of purchases on the financial well-being of the people of the US, financial markets, and financial institutions;
- The extent to which the information made available on transactions has contributed to market transparency; and
- The effectiveness of the financial assistance provided under this title of minimizing long-term costs to the taxpayer and maximizing the benefits for taxpayers.

In light of the information that Congress is likely to request from the Treasury Department, the Federal Reserve, and others, we expect that applications for direct financial assistance will likely require substantial information – which will be made publicly available – addressing the above-mentioned points that must be addressed in the Commission's monthly report to Congress.

As such, applicants would be advised to consider how making such information public could impact business. To the extent an eligible business does wish to seek loans or loan guarantees directly from Treasury, it should begin collecting and putting together sufficient information now about its business structure, employees, financial situation, etc. that would typically be needed in applying for a loan from a bank.

Federal Reserve Facilities

Overview and Authority to Establish and Access Funding and Liquidity Facilities

The Act permits the Secretary of the Treasury to use US$454 billion (plus any sums not used as part of the Treasury's direct lending program) to provide financial assistance to support funding and liquidity facilities established by the Federal Reserve. The Federal Reserve, with the concurrence of the Secretary of the Treasury, has pre-existing statutory authority pursuant to Section 13(3) of the Federal Reserve Act to establish and support broad-based lending facilities (*i.e.*, not designed for the purpose of aiding any number of failing firms and in which at least five entities would be eligible to participate) as long as the businesses or entities are:

- Solvent;
- The credit is collateralized (*i.e.*, sufficient to protect taxpayers from losses);
- The extension of credit is subject to a penalty rate (*i.e.*, a level that is a premium to the market rate in normal circumstances, affords liquidity in unusual and exigent circumstances, and encourages repayment and discourages use of the program as circumstances normalize).

Since the start of the pandemic, the Federal Reserve has used this authority to "discount" notes (i.e., lend). Pursuant to such authority, the Federal Reserve recently established five 13(3) facilities aimed at supporting liquidity in specific markets. Those facilities are the following:

- Primary Market Corporate Credit Facility;
- Secondary Market Corporate Credit Facility;
- Term Asset-Backed Securities Loan Facility;
- Money Market Mutual Fund Liquidity Facility; and
- Commercial Paper Funding Facility

Each of these facilities establishes its own terms, conditions, etc. for extending credit to eligible applicants, though loan forgiveness is not permissible through any of these facilities. For example, the Primary Market Corporate Credit Facility was established to extend credit to companies to ensure that they are able to maintain business operations and capacity during the period of dislocations related to the COVID-19 pandemic. This facility provides bridge financing for up to four years for investment grade companies. Moreover, borrowers may elect to defer interest and principal payments during the first six months of the loan (though that period may be extended at the Federal Reserve's discretion) in order to have additional cash on hand to pay employees and other obligations. The Federal Reserve on March 23, 2020, announced that it will finance a special purpose vehicle (SPV) to make loans from the Primary Market Corporate Credit Facility to companies; the Treasury, through the Exchange Stabilization Fund, will make an equity investment in the SPV. Note, the Federal Reserve's term sheets for the Primary and Secondary Market Corporate Credit Facilities indicate that "companies that are expected to receive direct financial assistance under pending federal legislation" are unable to access these facilities.

Eligibility Requirements

In addition to the terms and conditions established by the Federal Reserve in connection with each credit facility, the Act requires that any entity that receives support from a new facility established as a result of the Act must comply with the restrictions on stock buybacks, common stock dividends, and compensation applicable to direct lending by the Treasury Department (described above in the discussion on Treasury direct lending). While the Treasury Secretary has the authority to determine that the waiver of such restrictions is in the interests of the US, he would need to explain this determination to Congress and potentially pay a steep political price.

Establishment of a Credit Facility for Mid-Size Business

The Act specifically "encourages" the Secretary of the Treasury to support a Federal Reserve credit facility that supports lending to small and mid-sized businesses. We expect that the Federal Reserve will leverage banks and other lenders to make direct loans to nonprofits and businesses with between 500 and 10,000 employees.

Loans from such a facility are appealing in their terms: the interest rate is capped 2-percent, unlike the requirement for loans made through other facilities that must charge a penalty rate, and no principal or interest payments are due during the first six months after the loan is made. Additionally, any business or other entity that receives support through this facility would be required to use the funds to:

- Retain at least 90-percent of its work force as of March 24, 2020, at full compensation and benefits through September 30, 2020;
- Restore 90-percent of its work force that existed as of February 15, 2020 at full compensation and benefits within four months of the termination of the national emergency established in response to the COVID-19 outbreak;
- Not pay dividends on common stock as long as the loan is outstanding;
- Not outsource or offshore jobs for two years after the loan is repaid;
- Not abrogate a collective bargaining agreement for two years after the loan is repaid; and
- Remain neutral in any union organizing effort.

Separately, the Federal Reserve also has announced that it expects soon to establish a Main Street Business Lending facility to support lending to eligible small- and medium-sized businesses in order to order to complement efforts by the Small Business Administration. As with any new credit facility established by the Federal Reserve as a result of this Act, to the extent this facility receives funding pursuant to the Act, recipients of support from the Main Street Business Lending facility would be subject to dividend, stock buyback, and compensation restrictions.

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