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Memorandum

Senate Bill Includes Historic Economic Stabilization Provisions to Support Financial Markets

March 26, 2020

On March 25, 2020, the U.S. Senate passed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), a historic economic stimulus package that provides broad-based relief to support a wide swath of the U.S. economy, including provisions focused on supporting the American workforce, healthcare system and impacted industries.[1]

Title IV of the CARES Act includes the Coronavirus Economic Stabilization Act of 2020 (the "Stabilization Act"), a set of significant economic stabilization and regulatory relief measures that, together with the Federal Reserve's recent announcements of various liquidity programs under its emergency lending authority, aim to support overall market functioning and credit provision in the U.S. financial markets in the face of the ongoing coronavirus disease 2019 ("COVID-19") pandemic. The Stabilization Act also provides various mortgage payment and foreclosure moratorium provisions and other consumer relief measures. The following provides a high-level summary of the Stabilization Act's key features.

Treasury Emergency Relief Funding

The Stabilization Act authorizes the Treasury Department to make up to $500 billion in loans, loan guarantees and other investments in support of eligible businesses, states and municipalities.[2] Eligible businesses are broadly defined to include any U.S. business that has not otherwise been specifically provided adequate economic relief under the Stabilization Act.

Of the $500 billion authorized for Treasury loans, guarantees and investments, $46 billion would be earmarked for loans and loan guarantees to companies in the airline and national security industries (including $25 billion for passenger carriers and travel agents, $4 billion for cargo air carriers and $17 billion for businesses critical to maintaining national security).[3] The remaining $454 billion (plus any amounts unused for loans and loan

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[1] A number of CARES Act provisions will be addressed in subsequent firm memoranda.

[2] The funding to businesses under the Stabilization Act is in addition to the $349 billion to be made available to small businesses through Small Business Administration loan programs under other sections of the CARES Act.

[3] For loans or loan guarantees made to companies in the airline or national security industries, Treasury must receive a warrant, equity interest or, in the case of a non-publicly-traded company, a senior debt instrument of the borrower. Within ten days of the enactment of the CARES Act, the Treasury is required to publish procedures for applications and minimum requirements for making loans, loan guarantees, or other investments in the airline and national security industries.

guarantees to companies in the airline and national security industries) will be available to make loans and loan guarantees to, and other investments in, programs or facilities established by the Federal Reserve for purposes of providing liquidity to the financial system. Since the Federal Reserve's emergency liquidity programs have typically had funding limits of ten times the amount of Treasury support, the amount of Treasury funding authorized by the Stabilization Act could theoretically support well over $4 trillion of Federal Reserve liquidity facilities.[4]

Any Federal Reserve program or facility receiving Treasury loans, guarantees or investments pursuant to the Stabilization Act will be limited to lending to (including loans or other advances secured by collateral), or purchasing obligations or other interests (other than securities based on an index or diversified pool of assets) from, only U.S. companies with significant operations, and a majority of its employees, in the United States. The Stabilization Act does not define or otherwise provide specific parameters for the requirement that a U.S. company have "significant operations" in the United States in order to participate in a Federal Reserve program supported by the Treasury.

Such Federal Reserve programs will also be required to comply with applicable requirements (including loan collateralization, taxpayer protection and borrower solvency requirements) under Section 13(3) of the Federal Reserve Act, which provides the Federal Reserve with emergency lending authority to companies other than depository institutions through broad-based programs and facilities that relieve liquidity pressures in financial markets. Notably, the Federal Reserve's Section 13(3) emergency lending authority was significantly amended by the Dodd-Frank Act following the Global Financial Crisis, including to require that Federal Reserve emergency lending programs or facilities have "broad-based eligibility" (which has been defined by regulation to mean a program or facility designed to provide liquidity to an identifiable market or sector of the financial system, with five or more eligible companies) and be "for the purpose of providing liquidity to the financial system, and not to aid a failing financial company."

Since the outbreak of the COVID-19 pandemic to date, the Federal Reserve has announced six such liquidity funding programs pursuant to its Section 13(3) emergency lending authority, including the Primary Dealer Credit Facility ("PDCF"), Commercial Paper Funding Facility ("CPFF"), Money Market Mutual Fund Liquidity Facility ("MMLF"), Primary Market Corporate Credit Facility ("PMCCF"), Secondary Market Corporate Credit Facility ("SMCCF") and Term Asset-Backed Securities Loan Facility ("TALF"). Of these, only the PDCF (which became available on March 20, 2020) and the MMLF (which became available on March 23, 2020) are currently operational.[5] Other than the PMCFF and the SMCCF, all of the Federal Reserve's recently announced liquidity programs are similar to programs that the Federal Reserve operated during the Global Financial Crisis.

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[4] For context, total Federal Reserve Bank assets were approximately $4.2 trillion as of December 31, 2019.

[5] For additional detail regarding the PDCF, please see our March 18 memorandum available here, and for additional information regarding the CPFF, MMLF, PMCCF, SMCCF and TALF, please see our March 24 memorandum available here. The Federal Reserve is expected to release additional information regarding these programs and facilities in the near future.

In addition to those programs already announced, the Federal Reserve has expressed its intent to establish a "Main Street Business Lending Program" to support lending to eligible small-and-medium sized businesses, complementing efforts by the SBA. Relatedly, the Stabilization Act specifically directs the Treasury Department to seek the implementation of a Federal Reserve liquidity program or facility that finances direct loans to eligible businesses and nonprofit organizations (to the extent practicable) with between 500 and 10,000 employees ("Mid-Sized Businesses Program"). Such direct loans would be subject to a maximum 2% annual interest rate, with no payment due for the first six months (or longer period as determined by the Treasury Secretary) of the loan. A borrower under these direct loans would be required to provide a number of certifications relating to its solvency, labor and workforce retention commitments (including to use loan proceeds to retain at least 90% of its workforce, at full compensation and benefits, until September 30, 2020 and to remain neutral in any union organizing activity for the term of the loan), and domestic operations commitments (including commitments not to outsource or offshore jobs for the term of the loan and two years after repayment). The Stabilization Act also directs the Treasury Department to seek the implementation of a Federal Reserve liquidity program or facility that supports lending to states and municipalities.

Treasury is authorized to make new loans, loan guarantees and other investments using the Stabilization Act appropriated funds until December 31, 2020. From January 1, 2021, any remaining amount of the $500 billion in appropriated funds may be used only for modifications, restructurings or other amendments of loans, loan guarantees or other investments; exercising options, warrants or other investments; and paying costs and administrative expenses.

Executive Compensation, Share Repurchase and Dividend Restrictions

Treasury-supported Federal Reserve liquidity programs that provide direct loans to eligible businesses must require the borrower to comply with restrictions on share buy-backs, dividends and executive compensation, as described below.[6] The Treasury Secretary has authority, however, to waive these restrictions.

Because the Stabilization Act imposes these only on borrowers participating in "direct loan" Federal Reserve programs, such restrictions should not be applicable to liquidity programs that provide funding through securities or asset purchases, such as the CPFF, SMCCF or the PMCCF—to the extent such PMCCF funding is in the form of securities purchases—each as currently proposed by the Federal Reserve.

By contrast, funding provided through the TALF, PMCCF—to the extent such PMCCF funding is in the form of direct loans—and MMLF, each as currently proposed, as well as the contemplated Main Street Business Lending Program and Mid-Sized Businesses Program, would be expected to be subject to the share buy-back, dividend and executive compensation restrictions to the extent not waived by the Treasury Secretary.

[6] Such restrictions on share buy-backs, dividends and executive compensation are also applicable to airlines and national security companies receiving direct Treasury funding under the Stabilization Act.

A. SHARE REPURCHASE AND DIVIDEND RESTRICTIONS

From the date of the direct loan under a Federal Reserve liquidity program to the eligible business until one year after the loan is repaid, the direct loan eligible business must agree not to repurchase any publicly listed equity securities of the eligible business or of its parent company, except to the extent required under a preexisting contractual obligation. In addition, the direct loan eligible business must agree not to pay dividends or make any other capital distribution with respect to its common stock until one year after the loan is repaid.

B. EXECUTIVE COMPENSATION RESTRICTIONS

From the date of the direct loan under a Federal Reserve liquidity program to the eligible business until one year after the loan is repaid (the "restricted period"), the eligible business must comply with the following restrictions:

- **Compensation Freeze**: Any officer or employee of the eligible business whose 2019 total compensation exceeded $425,000 cannot receive total compensation greater than their 2019 total compensation during any 12 consecutive months of the restricted period.
- **Compensation Reduction**: Any officer or employee of the eligible business whose 2019 total compensation exceeded $3 million cannot receive total compensation greater than the sum of (i) $3 million and (ii) 50% of the excess of their 2019 total compensation over $3 million[7], during any 12 consecutive months of the restricted period.
- **Severance Cap**: Any officer or employee of the eligible business whose 2019 total compensation exceeded $425,000 cannot receive more than twice their 2019 total compensation as severance pay during the restricted period.

For these purposes, total compensation includes salary, bonuses, stock awards and other financial benefits.

The Stabilization Act permits the Treasury Secretary to waive the requirement that borrowers participating in "direct loan" Federal Reserve liquidity programs comply with the above share buy-back, dividend and executive compensation limits upon a determination that such waiver is necessary to protect the interests of the federal government. The Treasury Secretary would be required to make himself available to testify before the Senate Banking Committee and House Financial Services Committee to explain any such waiver. The Treasury Department has not stated how it will use this waiver authority.

[7] For example, an officer or employee whose 2019 total compensation was $5 million would have their total compensation capped at $4 million ($3 million *plus* 50% of the $2 million in excess of $3 million).

C. INTERPRETATIVE ISSUES RELATING EXECUTIVE COMPENSATION RESTRICTIONS

Additional guidance will also be necessary to fully understand and implement the compensation restrictions described above, including with respect to the following:

- Whether the restrictions apply only to officers and employees of the entity that is the legal borrower of the direct loan, or whether it includes officers and employees of affiliates. Unlike the share repurchase restrictions, which expressly impose buyback restrictions at the ultimate parent-company level as well as the borrower level, the executive compensation restrictions by their terms apply only to the officers and employees of the particular entity that is the direct recipient of the direct loan, and not to the officers and employees of that entity's affiliates;
- The treatment of compensation for 2019 that has been deferred or that was subject to vesting over future periods;
- The impact of employer contributions to retirement plans and health and welfare plans on the determination of the executive compensation limits; and
- In determining the "total compensation" provided by an eligible business, the methodology for valuing awards of stock (*e.g.*, grant date value vs. realized value during the applicable period) and the scope and valuation of "other financial benefits."

Funding Oversight

The CARES Act includes several oversight provisions, including the following:

- **Special Inspector General**: The CARES Act establishes within the Treasury Department an Office of the Special Inspector General for Pandemic Recovery to be headed by a Special Inspector General (similar to the inspector general position created for the Troubled Asset Relief Program). The Special Inspector General, to be appointed by the President and confirmed by the Senate, will conduct audits and investigations of the Treasury loans, loan guarantees and other investments under any program established pursuant to the CARES Act. Within 60 days of the Special Inspector General's appointment, and every quarter thereafter, the Special Inspector General will be required to submit a report to a Congressional committee that includes a detailed report of all loans, loan guarantees, other transactions, obligations, expenditures, and revenues associated with the programs in which Treasury participates.
- **Congressional Oversight Commission**: The Stabilization Act establishes a Congressional Oversight Commission (the "Commission") to oversee efforts by the Treasury and Federal Reserve to provide economic stability as a result of the COVID-19 pandemic. The Commission will be comprised of two House designees, two Senate designees, and a fifth person selected as chairperson by the Speaker of the House

and the Senate majority leader (after consultation with the minority leaders of the House and Senate). The Commission will issue reports on such efforts every 30 days and may carry out hearings and receive evidence as necessary to perform its oversight duties. The Commission will terminate on September 30, 2025.

- **Treasury Reporting**: Within three days following any loan, loan guarantee, or investment by the Treasury to a company in the airline and national security industries, Treasury will be required to publish on its website a description of the transaction, including key transaction terms, the identity of the counterparty, and copies of relevant documentation. Within seven days of any transaction, Treasury also will be required to submit reports to various Congressional committees summarizing its lending and investment activities under the programs established under the Stabilization Act, and publish a report every 30 days summarizing such activities.
- **Federal Reserve Reporting**: The Federal Reserve will be required to provide reports to the Senate Banking Committee and House Financial Services Committee not later than seven days after the authorization of a new loan or other financial assistance program detailing the transaction, including the amount and material transaction terms, the identity of the recipients of the assistance, a justification for action, any requirements imposed on the recipients of the assistance, and the expected costs to the U.S. taxpayers. The Federal Reserve will also be required to provide monthly reports to these Committees including collateral valuations, the amount of interest, fees, and other revenue or items of value received in exchange for the assistance, and the expected or final cost to the taxpayers of such assistance. All reports submitted by the Federal Reserve must be made publicly available on its website within seven days.
- **Congressional Testimony**: The Treasury Secretary and the Chairman of the Federal Reserve will be required to testify before the Senate Banking Committee and the House Financial Services Committee on a quarterly basis regarding the transactions entered into under the Stabilization Act.
- **Prohibition on Participation By Government Officials**: The Stabilization Act prohibits any entity from receiving Treasury loans, loan guarantees or other investments, or from participating in a Treasury-supported Federal Reserve liquidity program or facility, if the entity is at least 20% owned by the U.S. President or Vice President, the head of any Executive department, a member of Congress or certain of their family members.

Consumer Financial Protection Measures

The Stabilization Act includes several consumer financial protection provisions, including the following:

- **Credit Reporting Requirements**: Retroactively from January 31, 2020 until 120 days following the enactment of the Stabilization Act (or the termination of the declared COVID-19 national emergency, if earlier), persons furnishing information to consumer reporting agencies must report consumer credit obligations or accounts as "current" if the consumer makes payments or is otherwise not required to make payments pursuant to an accommodation (including payment forbearance, modified payment schedules or other relief) granted by the furnisher. If the credit obligation or account was delinquent before the accommodation, the furnisher must maintain the status reported prior to the accommodation and update the consumer's status if the consumer becomes current on the account during the accommodation period.

- **Moratoriums on Evictions and Residential Mortgage Foreclosures**: Beginning March 18, 2020 until at least May 17, 2020, a servicer of a federally backed residential mortgage loan (including loans purchased or securitized by Fannie Mae and Freddie Mac, insured by HUD, VA or USDA, or directly made by USDA) may not initiate any foreclosure process or execute a foreclosure-related eviction for any occupied property. Similarly, for 120 days from the date of the Stabilization Act's enactment, landlords will be prohibited from initiating eviction actions against tenants for nonpayment of rent or charging additional fees or penalties related to nonpayment of rent if the landlord's mortgage on the property is federally backed. These moratoriums do not require a showing that the tenant default was COVID-19 related.
- **Residential Mortgage Forbearance Requirements**: Borrowers with a federally backed residential mortgage loan who experience a financial hardship due to the COVID-19 pandemic may request a payment forbearance from their mortgage loan servicer. Servicers of such federally backed mortgage loans must grant the requested forbearance requests for up to 180 days, with a further 180-day extension of the forbearance period at the request of the borrower (with no documentation required other than the borrower's attestation of a financial hardship caused by the COVID-19 pandemic, and with no additional fees, penalties or interest).[8]

  The moratoriums on mortgage payments, foreclosures and evictions in the Stabilization Act resemble recent action by the Federal Housing Finance Agency directing Fannie Mae and Freddie Mac to implement similar moratoriums for certain GSE-backed mortgages.
- **Mortgage Forbearance Requirements for Multifamily Properties**: Borrowers of federally backed mortgages on multifamily properties who experience a financial hardship due to the COVID-19 pandemic and who were current on their payments as of February 1, 2020 may request a payment forbearance from their mortgage loan servicer. Servicers of such federally backed mortgage loans must grant the requested forbearance requests for up to 30 days, with two possible 30-day extensions at the request of the borrower. Multifamily mortgage borrowers who receive a forbearance will be prohibited from evicting any tenant or charging any fees or other charges for the late payment of rent for the duration of the forbearance.

[8] Certain states have begun imposing mandatory payment forbearance requirements for mortgage loans made or serviced by state-regulated institutions. For information regarding New York State's recently imposed mortgage loan forbearance requirements, please see our March 25 memorandum available here.

Other Bank Regulatory and Accounting Relief Measures

In addition to the funding and liquidity support provisions, the Stabilization Act includes several provisions granting temporary regulatory or accounting relief to financial institutions, generally aimed at supporting the flow of credit in the U.S. financial markets.

- **Temporary Lending Limit Waiver**: Federal law limits the concentration of loans and other extensions of credit made by national banks to any one borrower to 15% of the bank's total capital and surplus, with an additional 10% of capital available if the exposure over 15% of capital is fully secured by readily marketable collateral, subject to exceptions for certain types of loans and borrowers. The Stabilization Act amends the scope of borrowers excepted from these national bank lending limits to include nonbank financial companies predominantly engaged in financial activities, and allows the OCC to grant an exemption from these bank lending limits for any transaction or series of transactions. Both such amendments will be effective until December 31, 2020 (or until the declared COVID-19 national emergency is terminated, if earlier).
- **Temporary Community Bank Leverage Ratio Relief**: Under the regulations adopted by the federal banking agencies pursuant to the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act, a qualifying community banking organization may elect to use a "community bank leverage ratio" framework pursuant to which it will be considered to have satisfied the risk-based and leverage capital requirements in the agencies' generally applicable capital rules if the qualifying community banking organization maintains a leverage ratio of greater than 9%. The Stabilization Act directs the federal banking agencies to issue an interim final rule lowering the community bank leverage ratio to 8%, and to allow a reasonable grace period for community banks to reestablish compliance with the community bank leverage ratio after falling below the minimum threshold, until December 31, 2020 (or until the declared COVID-19 national emergency is terminated, if earlier).[9]
- **Temporary Suspension of ESF Restrictions**: In 2008, following Treasury's use of the Exchange Stabilization Fund ("ESF") to backstop money market mutual funds during the Global Financial Crisis, the Emergency Economic Stabilization Act prohibited Treasury's use of the ESF for any future guarantee programs for the U.S. money market mutual fund industry. The Stabilization Act temporarily lifts this restriction from the date of the CARES Act enactment through December 31, 2020, permitting the use of the ESF to guarantee programs for the money market mutual fund industry during that time. Any guarantee will be limited to the total value of a shareholder's holdings in a participating fund as of the close of business on the day before the announcement of the guarantee.
- **Temporary FDIC Debt Guarantee Authority**: The Stabilization Act authorizes the FDIC to temporarily establish, through December 31, 2020, a program to guarantee debt, as well as noninterest-bearing transaction accounts, of solvent insured depository institutions and solvent insured depository

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[9] For additional information regarding the community bank leverage ratio, please see our November 11, 2019 memorandum available here.

institution holding companies. This authority is similar to the Debt Guarantee Program and Transaction Account Guarantee Program implemented by the FDIC during the Global Financial Crisis, which assisted banks (especially smaller ones) in retaining business and other transaction account deposits in excess of the normally applicable deposit insurance cap. In addition, it permitted banking organizations to issue FDIC-guaranteed term debt with a maturity of up to three years.

- **Temporary Relief From Troubled Debt Restructurings**: The Stabilization Act temporarily (from March 1, 2020 until December 31, 2020 or until 60 days following the termination of the declared COVID-19 national emergency, if earlier) suspends any U.S. GAAP requirements that a loan modified as a result of the effects of the COVID-19 pandemic be designated as a troubled debt restructuring ("TDR"), including impairment for accounting purposes. The Stabilization Act suspension applies only with respect to modifications of loans that were not more than 30 days past due as of December 31, 2019. The decision to suspend TDR designations for particular qualifying loans is optional for each banking organization.
- **Temporary Relief From CECL**: The Stabilization Act temporarily suspends the required application of the Financial Accounting Standards Board's recently effective (for certain large public banks) accounting standard for credit losses, known as the "Current Expected Credit Losses" methodology, or "CECL," for insured depository institutions, bank holding companies, and any of their affiliates until December 31, 2020 (or until the declared COVID-19 national emergency is terminated, if earlier).

Prospects for Enactment

The CARES Act underwent intense bipartisan negotiation and was approved by the Senate by a vote of 96 to 0. The bill is expected to be voted on by the House of Representatives in the next several days. In light of the overwhelming bipartisan support that the CARES Act received in the Senate, the bill is expected to be passed by the House when it is taken up on Friday, possibly by unanimous consent or voice vote due to the ongoing COVID-19 pandemic and a lack of rules allowing for House members to vote. Once passed by the House, the bill is expected to be signed immediately by President Trump.

For more information regarding the Stabilization Act, please contact any member of the Firm's Financial Institutions Group or Executive Compensation and Employee Benefits Group, including those listed below.

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