Insight

Financial Services Provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act – As Enacted

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Executive Summary

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act is a $2 trillion stimulus package with significant implications across financial services and nearly all other aspects of the economy.
- The final version of the Act is similar to earlier drafts in total funding available, mostly amplifying powers and expanding funding appropriated for these programs.
- The most significant addition to the final version of the Act is procedural: It establishes a Congressional Oversight Commission charged with overseeing the implementation of $500 billion in direct financial assistance from the Department of the Treasury.

Context

In the face of the economic and social disruption caused by the coronavirus, Congress has already passed two significant response packages to address health-sector needs and support American families. On March 25, Senate passed the "Phase 3" stimulus package, the Coronavirus Aid, Relief, and Economic Security (CARES) Act. With an estimated $2 trillion price tag, the third package would be one of the largest and most significant stimulus packages in American history.

This piece summarizes the implications of the final CARES Act specifically for financial services, focusing on high-level changes from the previous two Senate drafts. This piece builds on analysis performed for the first and second drafts of the Act, which may be found here and here.

Title I – Keeping American Workers Paid And Employed Act

The first title of the bill, "Title 1 – Keeping American Workers Employed And Paid Act," sets aside significant resources for the relief of small businesses and entrepreneurial programs, and for use by the Minority Business Development Agency. This relief is predominantly provided in the form of what are known as "7A Loans," so-called because they derive from section 7(a) of the Small Business Act.

The Paycheck Protection Program, or 7(a) Loans

Eligibility

Previous drafts of the CARES Act had indicated that any business concern, public or private nonprofit,

employing fewer than 500 employees would be eligible for a loan made under section 7(a) of the SBA, a definition that was later expanded to include veterans' organizations.

The final CARES Act expanded eligible categories of firms to include tribal business concerns. The bill also makes clear that when calculating the total number of employees, "employee" includes individuals on a full-time or any form of part-time basis.

Maximum Loan Amount

Any loan may be a maximum of $10 million, based on a calculation where the loan amount is the lesser of either a calculation based on average monthly expenses or $10 million. For the purposes of calculating the maximum loan amount, "payroll costs" is defined as not including individuals with salaries exceeding $100,000 annually.

The final CARES Act made no changes to this provision.

Allowable Uses Of Covered Loans

Funds from loans provided may be used for payroll support, employee salaries, mortgage payments, rent, utilities, and *any other debt obligations* incurred before the covered period. While in previous drafts of the CARES Act only interest payments on mortgages were an allowable use, the final Act expands this category to include all mortgage payments.

Additional Clauses

The final CARES Act adds two new clauses: the first permitting the refinancing of covered loans; and the second noting that loan administrators shall have no recourse for non-payment of a loan except where the loan is used for a nonauthorized purpose.

Interest Rate Requirements

Where previous iterations of the CARES Act had indicated that loans would bear no more than the maximum interest rate in effect on February 15, 2020, the final CARES Act requires that interest rates on loans never exceed 4 percent.

Sense of the Senate

The updated CARES Act suggests that guidance should be issued to authorized lenders that borrowers in underserved and rural markets, veterans, businesses owned by socially disadvantaged peoples, women, and businesses in operation for less than 2 years must be prioritized.

Commitments for 7(a) Loans

$349 billion is authorized for commitment under this program. There is no change in the final CARES Act.

Other Assistance

Entrepreneurial Development Programs

This section establishes $265 million of grants available for entrepreneurial development programs. Grants under this program seek to provide funds to research partners with the goal of establishing a centralized hub for COVID-19 information. There is no change in the final CARES Act.

Minority Business Development Agency

The final CARES Act newly defines a minority business as a for-profit business enterprise where at least 51 percent of the business is owned by what the Minority Business Development Agency deems socially disadvantaged individuals, and the Act sets aside $10 million for education and training of minority businesses. Only the provided definition of minority businesses has changed in the final CARES Act.

Loan Forgiveness

Borrowers will be eligible for loan forgiveness to an amount equaling payroll and operating costs, excluding the salaries of any employee exceeding $100,000, and reduced to factor in any reduction in payroll during the national emergency. The final CARES Act alters this section in only minor ways, including forgiveness for additional wages paid to tipped workers.

Appropriations

The final CARES Act appropriates the following funds:

- $349 billion for 7(a) loans provided;
- $675 million for Small Business Administration salaries and expenses;
- $25 million for the Office of the Inspector General (OIG) in connection with overseeing the Small Business Administration;
- $265 million for the entrepreneurial research grants;
- $10 million for minority business centers;
- $10 billion for emergency grants;
- $17 billion for loan subsidies;
- $25 million for Department of Treasury salaries and expenses; and
- $100 billion for secondary market guarantee sales.

These categories were reflected in the previous iteration of the CARES Act, with only slight variations in total funding.

Title IV – Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy

Title IV authorizes the Treasury to make loans directly to businesses impacted by the coronavirus. Particular restrictions are put in place where those businesses are airlines. The title also restores powers granted to the Secretary of the Treasury to use the Exchange Stabilization Fund (ESF) during the 2007-08 financial crisis to guarantee money market mutual funds. Finally, the final CARES Act introduces specific procedural oversight

mechanisms to govern the disbursement of funds under Title IV.

Direct Treasury Assistance

Total Funds Available

The previous iteration of the CARES Act significantly expanded the pool of funds available to the Treasury Secretary to $500 billion. Of this $500 billion, $50 billion was made available to passenger air carriers (section B1 loans) and $8 billion to cargo carriers (section B2 loans). The final CARES Act halves this support, with only $25 billion made available to passenger air carriers and $4 billion to cargo carriers, although in doing so the Act also provides for $29 billion in grants exclusively for the payment of wages and salaries of airline employees (this accompanies a new section specific to the support of air carrier workers). Additionally, both the final and the previous drafts of the Act make $17 billion available to businesses "critical to maintaining national security" (section B3 loans).

The remaining $454 billion (increased from $425 billion) and any funds not used in the categories above would become available to the Secretary to make loans and other investments in the support of programs established by the Board of Governors of the Federal Reserve System that support lending to eligible businesses, states, or municipalities (section B4 loans). Where previously this assistance was considered solely in terms of purchasing obligations in either the primary or secondary markets, the final CARES Act also specifically creates the power simply to issue loans. Additionally, the final CARES Act updates some key definitions: an eligible business must not have otherwise received adequate financial assistance elsewhere under the Act; and it defines municipality and state, with the latter covering any of the 50 states, the District of Columbia, any of the territories and possessions of the United States, and any Indian tribe.

Terms

The terms (including rates) of these loans are at the Secretary's discretion, with restrictions as follows: a) Recipients must not have reasonably available credit; b) The intended obligation must be "prudently incurred"; and c) The loan must be sufficiently secured.

The final CARES Act includes a requirement specific to B4 loans that recipients of a loan must not repurchase any outstanding equity agreements, i.e. participate in stock buy-backs, for the duration of the loan. Similarly, borrowers must not pay dividends for the duration of the loan. Both of these requirements may be waived by the Treasury if deemed necessary to protect the interests of the federal government. Borrowers must also maintain existing employment levels.

When contracting with businesses, the Secretary must ensure that the federal government is compensated to the extent possible. For B1, B2, and B3 loans, the Secretary in the previous iteration of the CARES Act allowed the federal government to participate in the gains of borrowers (for example via equity instruments); the final Act *requires* that the federal government be granted a warrant, equity interest, or senior debt instrument. Any funds collected this way must reimburse the Treasury, and any funds collected in excess be deposited into the Federal Old-Age and Survivors Insurance Trust Fund (previously the Airport and Airway Trust Fund).

As before, the principal of any these loan or other obligations cannot be reduced by debt forgiveness.

Of the new additions to these terms under the final CARES Act, it also becomes a requirement that recipients of

a loan, under any of the categories recognized above, must be created, organized and have a significant presence in the United States.

Employee Compensation

Any borrower under this provision must undertake, for a two-year period beginning March 1, 2020, that it will cap the pay of any individual employee who earned more than $425,000 in total compensation (including bonuses and equity) in 2019, and would be prohibited from providing departing senior executives with so called "golden parachutes" or exit payments worth more than twice their annual salary. The final CARES Act adds an additional requirement, that individual employees who made more than $3 million in 2019 have their pay capped at $3 million plus 50 percent of excess over $3 million.

The Exchange Stabilization Fund

The CARES Act temporarily suspends the statutory limitation on the Exchange Stabilization Fund (ESF) established in Section 131 of the Emergency 15 Economic Stabilization Act of 2008. These restrictions require that the ESF be refunded and prohibits the Treasury from using the ESF for the establishment of future guaranty programs. These restrictions were lifted, however, in the 2007-08 financial crisis, and the Act once again removes these restraints. Although the ESF was originally created for currency market interventions, it is typically well funded and can be used discretionally, which makes it a very tempting target in times of stress. The Act does, however, limit this period by establishing an end date of December 31, 2020, and it requires that the fund be reimbursed once this period is over.

The final CARES Act limits any guaranty provided by Treasury to the total value of a shareholder's holdings as of the close of business the day before the guaranty comes into force.

New Oversight Mechanisms

A Congressional Oversight Commission

The final CARES Act establishes a Congressional Oversight Committee within the legislative branch charged with the oversight of disbursement of funds by Treasury and the Federal Reserve under Title IV. This commission would have five members, one appointed by each of the House Speaker, the House Majority Leader, the Senate Majority Leader, the Senate Minority Leader, and a fifth jointly by House Speaker and House Majority Leader.

The Act provides for the commission to hold hearings and take testimony. The commission would report to Congress every 30 days, and be disbanded on September 30, 2025. Any sums necessary to this commission would be derived half from the House of Representatives and half from the Senate.

A Special Inspector General for Pandemic Recovery

The final CARES Act also provides specifically for a Special Inspector General for Pandemic Recovery within Treasury. At the appointment of the president, the special inspector general would conduct audits of all loans and other investments issued by Treasury under Title IV. The special inspector general would report to Congress quarterly. Of the $500 billion authorized to Treasury under this Title, $250 million is to be made available to the special inspector general for carrying out these duties.

On Conflicts of Interest

Any company where a controlling interest (defined as over 20 percent of controlling stock) is held by president, the vice president, executive department head, or Member of Congress or their families is rendered ineligible for financial assistance in the form of loans or investments provided under the CARES Act.

Additional Provisions

Title IV also contains other provisions, many of them aimed at relieving the regulatory burden on banks and other sources of finance. One section would waive the requirement that the Federal Reserve conduct open meetings. Other clauses seem aimed at reducing the regulatory and compliance burdens on banks during this national emergency, including setting the capital leverage ratio of community banks to 8 percent, giving the Federal Deposit Insurance Corporation (FDIC) expanded authority to guarantee bank accounts, and making it easier for banks to restructure troubled debt. In particular, banks have been dreading the introduction of a new accountancy standard on Current Expected Credit Losses (CECL). The Act would delay compliance with CECL until the earlier of December 31st and the end of the national emergency.

The final CARES Act does not meaningfully change these provisions, but does add provisions relating to foreclosure and eviction moratoria and forbearance of residential mortgage loan payments, in addition to credit protections in information provided to credit rating agencies.

Conclusions

The CARES Act has two key implications for financial services. First, it would significantly expand the scope of loans available to small businesses under the Small Business Act. These potential gains, however, must be offset against the very real costs passed on to small businesses by the Families First Coronavirus Response Act, leaving the true position for small businesses difficult to ascertain. Second, the Act would provide the Treasury with two powerful tools of direct financial intervention. The first is the ability to offer direct loans to businesses impacted by the coronavirus. This $500 billion fund expressly includes $454 billion for use by the Secretary of the Treasury in connection with Federal Reserve 13(3) liquidity programs, although the exact interface between Treasury and the Federal Reserve remains unclear. The second is unlimited use of the Exchange Stabilization Fund to guarantee money market mutual funds, which are extremely critical financial instruments to short-term liquidity in the market, until the end of the year.

The final CARES Act provides only incremental changes in terms of total funding from the first two drafts. Most notably, it would halve the support available under Title IV to airlines, although that deficit is made up by the establishment of grants available for the purposes of paying airline salaries and wages. More significant are the procedural oversight changes. With the establishment of an oversight board similar to the one that supervised the Troubled Asset Relief Program in 2008, the Senate would create a legislative body with the power to hold the Treasury Secretary to account for $500 billion of loans and investments made.