



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

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Executive Summary

- On March 22, Senate Republicans released a revised draft of the CARES Act that reflected Democratic input; the Act is now a two trillion-dollar stimulus package with significant implications across financial services, tax, health and all other aspects of the economy.
- This second draft is similar from the first, mostly amplifying powers granted in the first draft and expanding funding appropriated for these programs.
- The most significant addition to the draft Act is \$425 billion in loans and investments that the Treasury Secretary may direct in accordance with Federal Reserve liquidity programs and expands the list of eligible borrowers to states and cities in addition to businesses.

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 19, Senate Majority Leader Mitch McConnell released the [Senate Republican draft](#) of the Phase 3 stimulus package, known as the Coronavirus Aid, Relief, and Economic Security (CARES) Act. With an estimated trillion-dollar price tag, this third package would be one of the largest and most significant stimulus packages in American history, although initial estimates suggest that the new package is closer to [\\$2 trillion](#).

On March 22, Senate Republicans released an [updated draft](#) of the CARES Act with significant bipartisan support to be presented to the Senate. House Speaker Nancy Pelosi has since announced that she would not support the CARES Act, and that in fact the House would begin to [draft its own coronavirus stimulus package](#), throwing the future of the CARES Act into some question.

This piece summarizes the implications of the updated CARES Act specifically for financial services. This piece builds on analysis performed for the first draft of this Act, which may be found [here](#).

Implications for Financial Services

Division A – Keeping Workers Paid And Employed, Health Care System Enhancements, And Economic Stabilization

Title 1 – Keeping American Workers Employed And Paid Act

The text below is analysis from the first draft of the CARES Act.

The first section of the draft bill, titled “Division A – Small Business Interruption Loans,” sets aside significant resources for the relief of small businesses, 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 rule proposes that any business concern, public or private nonprofit, employing fewer than 500 employees is eligible for a loan made under section 7(a) of the Small Business Act for not greater than \$10 million (where the loan amount is the lesser of either a calculation based on average monthly expenses or \$10 million). That loan may be used for payroll support, employee salaries, mortgage payments, rent, utilities, and *any other debt obligations* incurred before the covered period. The borrower must not already be receiving support under the Small Business Act, but this Division also sets out generous provisions for existing loan forgiveness. Businesses will be able to achieve loan forgiveness to the value of cost of payroll during the emergency, with loan forgiveness decreasing by number of employees laid off. The administrator of this loan may collect no fees or as few as possible.

This Division also establishes a series of grants available for entrepreneurial development programs, and it empowers the Minority Business Development Agency to provide financial assistance to qualifying small businesses disrupted by COVID-19.

This Division directly appropriates \$299.4 billion for the fiscal year ending September 30, 2020, to remain available until September 30, 2021, for the provision of these 7(a) loans, and \$265 million for entrepreneurial development programs. Also appropriated is \$300 million for the administration of the Small Business Act and \$25 million for the Office of the Inspector General (OIG) in connection with overseeing this administration. A final \$10 million is appropriated for minority business centers of the Minority Business Development Agency.

The Treasury will establish a list of criteria for insured depository institutions (provided they are sufficiently safe and sound) to participate in a small business interruptions program. The eligibility criteria of 7(a) will *not* apply to these loans. The Secretary of the Treasury is directed to set out terms, including compensation these institutions may receive.

The program will be administered until the COVID-19 national emergency expires.

The total cost of this provision is \$300 billion.

The new draft of the CARES Act would modify the eligibility of participating firms such that firms must either have fewer than 500 employees or be no larger than “the size standard in number of employees established by the Administration for the industry in which the business concern, nonprofit organization, or veterans organization operates.” Additionally, for the purposes of calculating the maximum loan amount, “payroll costs” is defined as not including individuals with salaries exceeding \$100,000 annually. The small businesses in question do not need to demonstrate that they could not achieve credit elsewhere, and the loan would require neither collateral nor a personal guarantee. 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 only change in direct appropriations is to expand the amount appropriated for the salaries and expenses associated with the administration of the Small Business Act from \$300 million to \$700 million.

The total cost of this provision has increased to \$349 billion.

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

The text below is analysis from the first draft of the CARES Act.

Division C of the draft bill, titled “Division C – Assistance to Severely Distressed Sectors of the United States Economy,” 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 rule proposes to authorize the Treasury Secretary to make or guarantee loans that do not, in aggregate, exceed \$208 billion. Passenger air carriers may receive no more than \$50 billion, and cargo air carriers no more than \$8 billion, with the total provided to other businesses not exceeding \$150 billion. The restrictions are 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. Any loan will be made at a rate not less than a rate determined by the Secretary on the basis of comparable average yield on instruments of comparable maturity. The Secretary must make application and term details available within ten days after the Act is enacted, and the Secretary must ensure that the federal government is compensated to the extent possible. The Secretary may contract with borrowers such that the federal government participates in the gains of borrowers (for example via equity instruments), and any amount collected must be deposited in the Airport and Airway Trust Fund. \$100 million of the total \$208 billion may be spent on the administration of these loans.

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.

If an air carrier, the Secretary may require the maintenance of scheduled air transportation service.

The total cost of this provision is \$208 billion.

The new draft of the CARES Act significantly expands the pool of funds available to the Treasury Secretary to \$500 billion. Of this \$500 billion, the same \$50 billion is made available to passenger air carriers (section B1 loans) and \$8 billion to cargo carriers (section B2 loans). Where previously \$150 billion was made available to other businesses impacted by coronavirus, the new CARES Act would make \$17 billion available to businesses “critical to maintaining national security” (section B3 loans).

The terms (including rates) of these loans are at the Secretary’s discretion. Many of these terms remain the same as noted in the analysis above. Of the new additions to these terms, perhaps most important is a requirement that recipients of a loan, under any of the categories recognized above, must not repurchase any outstanding equity agreements, i.e. participate in stock buy-backs, a term introduced at the request of [Senate Democrats](#). Borrowers

must also maintain existing employment levels.

The remaining \$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). This does not, however, appear to expand the powers available to the Federal Reserve to establish these programs. Recipients of a B4 loan must also undertake not to participate in any stock buy-backs while the loan or loan guarantee is outstanding. In addition, any requirement that B4 borrowers maintain employment levels is however curiously missing. Finally, B4 loans within this category expressly cannot be reduced by any loan forgiveness as is typical of loans of the kind.

The Treasury Secretary is authorized to ensure that the federal government receives commensurate compensation for the risks assumed as a result of loans extended. As before, the Secretary may contract with borrowers such that the federal government participates in the gains of borrowers (for example, via equity instruments), and any amount collected must be deposited in the Airport and Airway Trust Fund. The government, however, can only participate in gains in contracts in categories B1, B2, and B3, i.e. only the first \$75 billion of the \$500 billion pool. The bill would also require that recipients of these loans be identified within six months of loan assistance.

What is not entirely clear for the \$425 billion pool of capital available to struggling businesses that represent loans in category B4 is the interaction between the Federal Reserve and the Treasury Secretary, who can authorize the required loans and investments, but only to advance the interests of Federal Reserve liquidity programs. Given that almost half a trillion dollars is involved, it seems likely that the bill's authors are seeking to ensure that the Treasury and the Federal Reserve work in tandem for the disbursement of these funds. Perhaps the intent is that Treasury design loan programs for affected businesses, states, and municipalities, and the loans are then bought by the Federal Reserve via its 13(3) programs. The result is that businesses receive substantial relief on loans where the risk ends up being borne entirely by the Federal Reserve, which Treasury has the funds to finance if needed.

Title IV also contains a few new interesting provisions. One section would waive the requirement that the Federal Reserve conduct open meetings. Other clauses seemed 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). This bill would delay compliance with CECL until the earlier of December 31st and the end of the national emergency.

The total cost of this provision has increased to \$500 billion.

The text below is analysis from the first draft of the CARES Act.

Sec. 131.

Exchange Stabilization Fund reimbursement

(a)

Reimbursement

The Secretary shall reimburse the Exchange Stabilization Fund established under section 5302 of title 31, United States Code, for any funds that are used for the Treasury Money Market Funds Guaranty Program for the United States money market mutual fund industry, from funds under this Act.

(b)

Limits on use of Exchange Stabilization Fund

The Secretary is prohibited from using the Exchange Stabilization Fund for the establishment of any future guaranty programs for the United States money market mutual fund industry.

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 ESF was therefore tapped to shore up money market funds in the last crisis, although this temporary emergency power was ceded after the financial crisis. Division E restores that power.

The new draft of the CARES Act does not alter the removal of restrictions on use of the ESF. It does, however, limit this period by establishing an end date of December 31, and require that the fund be reimbursed once this period is over.

Conclusions

If enacted as law, 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 CARES Act would provide the Treasury with two powerful tools of direct financial intervention. First, direct loans to businesses impacted by the coronavirus. This fund has been increased from \$208 billion to \$500 billion and now expressly includes \$425 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. Second, unlimited use of the Exchange Stabilization Fund to guarantee money market mutual funds, extremely critical financial instruments to short-term liquidity in the market, until the end of the year.