Arnold & Porter

May 1, 2020 (Revised May 15, 2020)

Financial Services and Financing Reforms to Address the Economic Impact of the COVID-19 Pandemic

By David F. Freeman, Jr., Christopher L. Allen, Robert C. Azarow, David B. Bergman, Lawton M. Camp, James W. Cooper, Jonathan E. Green, Michael A. Mancusi, Henry G. Morriello, Michael Penney, Eric Whitney, Charles Yi, Karsten Giesecke, Paul A. Howard, Arturo Caraballo, Howard L. Hyde, Michael Karol, Stephanie G. Nygard, Eric Walsh, Amber A. Hay, Kevin M. Toomey, Anthony Raglani, Kara Ramsey, and Jöel S. Thompson

The unprecedented economic dislocation caused by the COVID-19 pandemic has prompted comprehensive legislative and administrative responses. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act or Act), signed into law on March 27, 2020, is the largest single piece of recovery legislation in US history. It is the third piece of federal legislation enacted in response to the COVID-19 crisis. Since then, a fourth bill has been passed to provide additional funding and relief, and still more legislation is in the works. Simultaneously, federal banking and financial services regulatory agencies—in part guided by their experience during the 2008 economic crisis—have developed their own programs to provide systemic liquidity and relief to hard-hit businesses and consumers. In addition, state agencies have moved to implement economic relief at the state level.

Unlike many industries that are largely shut down or sharply curtailed due to the pandemic, the financial services sector is generally seen by policymakers as a critical component of the solution. Many of the CARES Act's primary avenues for assistance to the business community are through loan and loan guarantee programs that rely on financial institutions to extend the credit and provide the liquidity needed by affected businesses. Loan programs such as the $500 billion Treasury Department loan/guarantee/investment program make up a substantial portion of the CARES Act. The CARES Act also provides financial regulators greater flexibility to address the crisis, even as the Board of Governors of the Federal Reserve System (Federal Reserve) had begun expanding its efforts, in the form of a wave of financing facilities, even before the legislation was enacted.

This Advisory discusses these two primary categories of financial- and market-related support and regulatory relief provided in response to the COVID-19 crisis: 1) statutory support and relief provided under the CARES

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

Act, and 2) the establishment of lending and liquidity facilities and various support actions taken independently by federal regulatory agencies, as well as actions taken by certain state governments.

CARES ACT RELIEF

Sunshine Act: The Act authorizes the Chair of the Federal Reserve to conduct meetings without regard to restrictions under the Sunshine Act, if exigent circumstances exist, until December 31, 2020, thereby allowing smaller subgroups of Federal Reserve Governors to hold discussions without being slowed down by the advance notice requirement and other provisions of the Sunshine Act.

HUD/SEC Vacancies: The Secretary of Housing and Urban Development (HUD) and the Securities and Exchange Commission (SEC) have the authority to recruit and appoint candidates to fill temporary and term appointments for responsibilities that "prevent, prepare for, or respond to COVID-19."

Paycheck Protection Program: Section 1102 of the Act amends the Small Business Act to create the Paycheck Protection Program (PPP). The PPP is a multibillion expansion of the loan program created under section 7(a) of the Small Business Act that is intended to keep small businesses solvent and workers on payrolls. Under the PPP, private lenders can originate loans of up to $10 million to small businesses, nonprofits, tribal concerns, sole proprietorships, independent contractors, self-employed individuals, and veteran organizations. The loans are fully guaranteed by the Small Business Administration (SBA) and, ultimately, by the US Treasury and may be fully forgiven when used for payroll costs, interest on mortgages, rent, and utilities. For the loan to be fully forgiven, borrowers must maintain (or quickly rehire) staff and their salaries at prescribed levels. Loan payments will be suspended for the first six months, although interest will continue to accrue, and no collateral or personal guarantees are required. Originally, Congress allocated $349 billion in funding to the PPP under the Act, to be administered by the SBA and the U.S. Treasury. However, after the program was depleted of funds in under a month, Congress approved an additional $310 billion in funding for the program as part of the total $484 billion rescue package under the Paycheck Protection Program and Health Care Enhancement Act enacted on April 24, 2020.[1] The total amount of funding that has been allocated to the PPP to-date is approximately $660 billion.

All FDIC-insured depository institutions and NCUA insured credit unions, as well as all SBA-licensed 7(a) bank and nonbank lenders are eligible to participate as lenders in the PPP program, by filing a special form with the SBA. Other nonbank lenders may also seek SBA approval to participate as lenders. PPP loan applications are made on a new SBA form and submitted by SBA-approved participating lenders to the SBA through a web-based portal for review and approval pursuant to SBA protocols, which generates an approval notice to the lender.

The terms of PPP loans are dictated by Treasury Rules and SBA guidance on the PPP program, as well as the statute and the terms in the notice of loan approval from the SBA.

Lenders may not charge fees to borrowers. The loan term on all loans is two years, and the interest rate on all loans will be one 1%. The SBA will pay lenders for processing PPP loans in the following amounts:

[1] Pub. L. No. 116-139, Paycheck Protection Program and Health Care Enhancement Act (April 2020). The $484 billion consisted of $310 billion for the PPP (with $30 billion allocated specifically to community banks, credit unions and other lenders, and $30 billion allocated to medium-sized banks and credit unions) , $12 billion for PPP administrative costs, $60 billion for the SBA's Economic Injury Disaster Loan Program (which includes $10 billion in emergency grants for businesses), $75 billion in resources for hospitals, and $25 billion for COVID-19 testing.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- 5% for loans of not more than $350,000
- 3% for loans of more than $350,000
- 1% for loans of at least $2,000,000

Treasury also rules contemplate lenders paying agents that provide certain services in connection with PPP loans, subject to certain limitations and disclosure requirements. Agent fees are to be paid out of lender fees and may not be collected from the applicant. Treasury guidance provides that agent fees for assistance in preparing PPP applications may not exceed:

- 1% for loans of not more than $350,000
- 0.5% for loans of more than $350,000
- 0.25% for loans of at least $2,000,000

PPP lenders must comply with applicable SBA and Bank Secrecy Act (BSA) requirements, but are otherwise held harmless for borrowers' failure to comply with Program criteria. The Financial Crimes Enforcement Network has issued guidance specifically addressing BSA compliance in the context of the CARES Act generally and the PPP specifically, which can be found here. Treasury guidance provides reassurance to lenders that they can rely on representations and certifications by borrowers of eligibility for PPP loans. Many lenders are nonetheless wary that they will be held responsible for applicants' errors or misstatements in PPP loan applications.

Recent guidance from SBA, Treasury, and federal banking regulators have added to many lenders' degrees of skepticism. The recent guidance signals that each of those government agencies will review the lending practices and implementation of the PPP by lenders. For example, on April 27, 2020, the Office of the Comptroller of the Currency stated in OCC Bulletin 2020-45, "[w]hile not requiring banks to obtain or maintain information beyond what exists in the ordinary course of business, the OCC is encouraging banks providing loans under the SBA PPP to prudently document their implementation and lending decisions." Moreover, as described below, SBA and Treasury have stated that actions of lenders and borrowers may be subject to scrutiny over the coming months.

Even before the second appropriation of PPP funds, accounts of perceived flaws in the PPP process received widespread attention. These included reports that larger companies, including publicly traded corporations, were able to obtain PPP loans, diverting funds from the smaller businesses that were intended to be the beneficiaries of the program. At the same time there were stories about bank lenders, particularly large banks, favoring existing larger customers at the expense of smaller customers or potential borrowers with no previous connection to the banks. These stories have resulted in new litigation, including purported class action suits, against lenders, borrowers, and the SBA itself. Additional information about litigation-related activities can be found here. The stories also contributed to the decision to set aside in the second round of funding $30 billion allocated specifically to community banks, credit unions and other lenders, and $30 billion allocated to medium-sized banks and credit unions.

The U.S Government Accountability Office, members of Congress, the SBA and Treasury have all raised concerns and indicated that, going forward, actions of lenders and borrowers will face enhanced scrutiny. For example, Senator Rubio, chairman of the Senate Committee on Small Business, sent a letter to the nation's largest lenders urging them to "ensure a neutral distribution of assistance" amid "reports of priority being given to certain applicants over others." Treasury Secretary Steven Mnuchin has made public comments discouraging larger companies, especially those with access to capital markets and other sources of liquidity for ongoing operations, from applying for loans under PPP. The borrower applications for PPP loans include certifications as to the planned use of the proceeds and the necessity to the borrower of obtaining the funds. Additionally, under Treasury's guidance for the PPP issued on April 23 (FAQ No. 31), 2020, borrowers were

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

reminded of the requirement that they make a good faith certification of the need for a PPP loan, taking into account other available sources of liquidity. Public companies and larger companies with adequate sources of liquidity were advised to not apply for PPP loans and, as a "safe harbor," were given the opportunity to repay PPP loan proceeds before May 7, 2020, if they determined that they were not in compliance with the good-faith certification. Additionally, on April 28, 2020, during a news conference, Treasury Secretary Steven Mnuchin stated that small business loans above $2 million will be subject to a full audit to make sure that they are valid.[2] He also raised the possibility of criminal liability in the case of false certifications. On May 14, 2020, the U.S. Department of Justice announced that it had charged an individual in Georgia with misuse of funds from a PPP loan and an individual in Texas with making fraudulent PPP loan applications.

FAQ No. 31 raised a number of questions among borrowers who had received PPP loan funds and were unsure how to interpret Treasury's guidance regarding the need certification. This uncertainty caused a sense of paralysis among borrowers who were unable to determine, in light of FAQ No. 31, whether to begin to spend the PPP loan funds for their intended purposes, including rehiring employees, or return the loan to the SBA. On May 5, 2020, Treasury published FAQ No. 43, which extended the safe harbor deadline for repaying PPP loans to May 14, 2020. On May 13, 2020, Treasury published FAQ No. 46 which provides that any borrower that (together with any affiliates that must be included pursuant to the affiliation rules applicable to PPP loans) received PPP loans of less than $2,000,000 would be deemed to have made the need certification in good faith. In addition, borrowers that do not return PPP loans and are subsequently determined by the SBA to have lacked an adequate basis for making the need certification will be asked to return the loan with no possibility for loan forgiveness. If such borrowers return the loans as requested, the SBA will not take any administrative enforcement action against them or refer the matter to other agencies for enforcement in respect of the need certification. Treasury has also further extended the safe harbor deadline for repayment of PPP loans to May 18, 2020.

After being fully disbursed, PPP loans may be sold in the secondary market (if one develops), and the SBA will not collect any fees for any loan or guarantee sold. Lenders began processing PPP loan applications on April 3, 2020, and the SBA is authorized to guarantee PPP loans originated through June 30, 2020 or until funds run out, on a first-come, first-served basis. As of the date of this advisory, however, even the second round of available PPP funds has almost been exhausted.

In order to promote PPP lending, the Federal Reserve has established a PPP Loan Financing Facility, which is discussed below. More recently, the Federal Reserve has temporarily modified its rules restricting the types and quantities of loans that bank directors, shareholders and officers, and businesses owned by these persons can receive from their related banks to permit these banks to make PPP loans to businesses owned by their directors and certain shareholders, subject to certain limits and without favoritism.

In addition, on April 7, 2020 the federal banking agencies adopted an interim final rule to neutralize the regulatory capital effects of banking organizations participating in the Facility. More information about the capital relief is provided here.

For a more detailed description of the PPP, see our prior Advisories: Small Business Loan Relief From CARES Act and Analysis of CARES Act for Non-Profit Organizations.

FDIC Debt Guarantee Programs: Section 4008 of the CARES Act amends Section 1105 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to authorize the Federal Deposit Insurance Corporation (FDIC) to establish a new Temporary Liquidity Guarantee Program (TLGP), as well as a new Transaction Account Guarantee (TAG) program, with expiration at the end of 2020. The TAG program applies

[2] See e.g., Lauren Hirsch, "Small business loans above $2 million will get full audit to make sure they're valid, Mnuchin says," CNBC, April 28, 2020

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

only to amounts in non-interest-bearing transaction accounts, such as checking accounts (demand deposit accounts and NOW accounts, but not MMDAs). However, under the TLGP, the FDIC can guarantee other forms of insured depository institution indebtedness. While Section 4008 requires that the FDIC establish a maximum limit for any such guarantee program, the statute itself does not set the limit. The FDIC has yet to implement these programs or release guidance on them, but similar programs put in place following the 2008 financial crisis and limited by Section1105 of the Dodd-Frank Act may serve as precedents. In 2008, by way of comparison, the TAG program had no maximum limit.

Section 4008 also gives the NCUA the authority to temporarily increase share insurance coverage for noninterest-bearing transaction accounts.

Any guarantee provided by the FDIC or insurance increase provided by the NCUA under Section 4008 must terminate by December 31, 2020. Nevertheless, the protection provided in the interim will encourage depositors to add to, or at least maintain, their deposits, providing valuable funding to institutions. For a discussion of administrative actions related to insured depository institution deposits, see the **Administrative Agency Deposit Guidance** discussion below.

Community Bank Leverage Ratio: Section 4012 of the CARES Act temporarily sets the Community Bank Leverage Ratio (enacted as part of Section 201 of the Economic Growth, Regulatory Relief and Consumer Protection Act) (CBLR) at 8% and provides a grace period to banks that fall below that ratio. These provisions expire at the earlier of (i) the end of the emergency declaration or (ii) December 31, 2020.

Separately, on March 22, the FDIC published answers to frequently asked questions (FAQs) for financial institutions affected by the COVID-19 crisis. The FAQs state that financial institutions have the flexibility to delay their CBLR elections. Previously, financial institutions were required to reflect their CBLR elections on their March 31, 2020 Consolidated Reports of Income and Condition (Call Reports); however, the FDIC's new guidance provides that a decision to elect CBLR for the March Call Report is not binding and may be reversed in a subsequent quarter.

On April 6, the federal banking agencies issued two interim final rules (IFRs) to implement Section 4012 of the CARES Act. The **first** IFR provides that, as of the second quarter 2020 and through December 31, 2020, the CBLR will be 8%. A community banking organization with a CBLR of 8% or greater (and that meets other qualifying criteria) may elect to use the CBLR framework during this period. Additionally, the IFR establishes a two-quarter grace period, during which a community banking organization that temporarily fails to meet any of the qualifying criteria, including the 8% CBLR requirement, will still be considered well-capitalized as long as it maintains a CBLR of at least 7%. The **second** IFR provides a gradual transition back to the previously required 9% CBLR. The CBLR will be 8.5% for 2021 and 9% thereafter.

Lending Limit Relief: Section 4011 authorizes the Comptroller of the Currency (Comptroller or OCC) to exempt loans or extensions of credit to any nonbank financial company (in addition to financial institutions) from the aggregate limits of loans to one borrower. In order to grant the exemption, the Comptroller must find that the exemption is in the public interest. The CARES Act does not define parameters for a finding that an exemption is "in the public interest," nor has the Comptroller issued any guidance regarding the agency's processing of exemption requests under Section 4011. Accordingly, the Comptroller will have significant discretion to determine whether an exemption request will be granted.

As has been the practice of the Comptroller in the past, it is likely that a national bank or federal savings bank will file exemption requests through its Supervisory Office. The exemption authority under Section 4011 terminates on the earlier of (i) the date the State of Emergency is terminated; or (ii) December 31, 2020.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

Troubled Debt Restructuring (TDR): Section 4013 of the Act allows financial institutions to elect to suspend the application of US Generally Accepted Accounting Principles (GAAP) to any loan modification related to COVID-19 from treatment as a troubled debt restructuring for the period between March 1, 2020 and the earlier of (i) 60 days after the end of the emergency declaration; or (ii) December 31, 2020 (the Relief Period).

Under Section 4013, a financial institution may elect to suspend GAAP only for a loan that was not more than 30 days past due as of December 31, 2019. In addition, the temporary suspension of GAAP does not apply to any adverse impact on the credit of a borrower that is not related to COVID-19. Neither the statute nor the federal banking agencies have provided guidance regarding what is "related to COVID-19." Although the statute provides a safe harbor for election of the suspension of GAAP, nothing prohibits examiners from questioning whether the modification is "related to COVID-19." A financial institution should develop internal parameters for determining whether a modification is "COVID-19-related" and document the rationale for concluding the election is permitted under Section 4013.

The suspension of GAAP is applicable for the entire term of the modification, including an interest rate modification, a forbearance agreement, a repayment plan, or other agreement that defers or delays the payment of principal and/or interest. Accordingly, a financial institution that elects to suspend GAAP should not be required to increase its reported TDRs at the end of the Relief Period, unless the loans require further modification after the Relief Period.

Delayed Adoption of Current Expected Credit Losses Methodology: Section 4014 of the CARES Act provides that banks or bank holding companies (or their affiliates) are not required to comply with the Financial Accounting Standards Board Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL), until the earlier of (i) the end of the emergency declaration or (ii) December 31, 2020. Although the delay may be welcome news for some institutions, others may have completed their full transition to CECL and may not be in a position to revert to the traditional credit loss methodology. Further, the permissive delay of the transition to CECL may only serve to assist with quarterly reporting for the first three quarters of 2020, meaning fourth quarter and full year 2020 audited financial statements will be subject to CECL.

On March 27, the federal banking agencies issued an IFR that provides banking organizations that implement CECL before the end of 2020 the option to delay, for two years, an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period. The IFR is intended to allow banking organizations to better focus on lending activities during the COVID-19 crisis. On March 31, the federal banking agencies issued a joint statement clarifying the interaction of the CARES Act, the IFR, and the regulatory capital rules (the Joint Statement). The Joint Statement provides the following illustrative examples of the interaction of these authorities:

- A banking organization required to adopt CECL on January 1, 2020 that elects to utilize statutory relief during the first three quarters of 2020, and then files reports using CECL starting in the fourth quarter of 2020, would have the option under the IFR to delay the estimated effect of CECL on regulatory capital over a period of five quarters (starting in the fourth quarter of 2020) along with its day-one CECL transition amount. This period would be followed by a three-year transition period to phase out the aggregate amount of such capital benefit.
- A banking organization with a calendar-year fiscal year that is required to implement CECL starting January 1, 2020, and that does not opt to use statutory relief, could utilize the IFR's transitional amounts in regulatory capital for eight quarters, followed by a three-year transition period to phase out the aggregate amount of such capital benefit.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- A banking organization with a fiscal year starting after January 1, 2020 that is required to implement CECL in 2020, and that does not opt to use statutory relief, could also make use of the IFR's transitional amounts in regulatory capital for eight quarters, followed by a three-year transition period to phase out the aggregate amount of such capital benefit.

On May 8, 2020, the federal banking agencies issued a final Interagency Policy Statement on Allowances for Credit Losses. The Policy Statement describes the measurement of expected credit losses using the CECL methodology and updates concepts and practices detailed in existing supervisory guidance that remains applicable. It will be effective at the time an institution adopts the credit losses accounting standard, which may be delayed as described above. At the same time, the agencies also finalized interagency guidance on credit review systems, which presents principles for establishing a system of independent, ongoing credit risk review in accordance with safety and soundness standards.

Exchange Stabilization Fund: Section 4015 of the Act suspends the Dodd-Frank Act prohibition on using the Exchange Stabilization Fund (ESF) to establish guarantee programs for money market funds until the end of 2020. It also provides for appropriations to reimburse the ESF after 2020 if claims exceed fees collected.

Accountability Measures: The massive Congressional response to the COVID-19 crisis is drawing obvious comparisons to actions taken during the 2008 financial crisis (e.g., the Troubled Asset Relief Program (TARP)). Thus far, policymakers do not appear worried that the assistance will be perceived—as it was during the financial crisis—as rewarding behavior that precipitated the problem. Nevertheless, there is substantial concern in Congress about giving Treasury and the Federal Reserve too much unilateral authority. At the same time, there is an understanding that, as this unprecedented crisis unfolds, those agencies will need a greater degree of flexibility than Congress might normally prefer to grant them. To balance these competing concerns, the CARES Act includes three key items.

- **Special Inspector General:** A key addition to earlier drafts of the CARES Act is the creation of a new Special Inspector General for Pandemic Recovery (SIGPR) within the Treasury Department. The SIGPR will have investigative and audit authority over "the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury under any program established by the Secretary under [the CARES Act.]" The SIGPR is directed to maintain current lists of businesses receiving assistance and total amounts outstanding, among other items. The Inspector General will also be required to submit quarterly reports to Congress on such information.
- **Conflicts of Interest:** This provision prohibits any emergency relief assistance for entities with a controlling interest (defined as at least a 20% equity interest) held by the President, Vice President, a federal agency head, a member of Congress, or an immediate family member of such officials.
- **Congressional Oversight Commission:** Not unlike the oversight panel created alongside TARP, the CARES Act establishes a 5-member Congressional Oversight Commission to oversee and report to Congress every 30 days on the implementation of the Act and on Treasury and the Fed's efforts to provide economic stability as a result of the pandemic.

Consumer Protection: The CARES Act also includes a number of provisions designed to provide relief to borrowers and tenants affected by COVID-19:

- **Credit Reporting**: Section 4021 of the Act amends the Fair Credit Reporting Act to protect borrowers from negative credit reporting arising from pandemic-related loan accommodations. Creditors that furnish information to consumer reporting agencies and that make an accommodation for a consumer who is affected by the COVID-19 pandemic during the period beginning on January 31, 2020, and continuing until the later of (i) 120 days from enactment of the Act (i.e., July 25, 2020) or (ii) 120 days after the end of the

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

national COVID-19 emergency, must continue to report the relevant account as current for as long as the consumer complies with the terms of the accommodation. If an account was delinquent prior to January 31, 2020, the creditor must continue to report that delinquent status for as long as the accommodation is in effect and the consumer complies with the terms of the accommodation, unless the consumer brings the account current, in which case the creditor must report the current status. An "accommodation" for purposes of this provision includes an agreement to defer one or more payments, to make a partial payment, to forbear any delinquent amounts, to modify a loan or contract, or any other assistance or relief granted to a consumer impacted by the pandemic.

- **Foreclosure Moratorium & Forbearance**: In connection with "Federally backed mortgage loans," Section 4022 of the Act creates a forbearance program for borrowers impacted by COVID-19 and imposes a temporary 60-day moratorium on foreclosures and foreclosure-related evictions. A "Federally backed mortgage loan" includes loans secured by a first or subordinate lien on residential 1- to 4-family real property that have been purchased by Fannie Mae or Freddie Mac, are insured by HUD, the VA, or the USDA, are guaranteed under certain provisions of the National Housing Act or the Housing and Community Development Act, or were made directly by the USDA. These provisions are discussed in greater detail below.
    - *Forbearance*. For all Federally backed mortgage loans, a borrower who is experiencing a financial hardship due directly or indirectly to the COVID-19 pandemic may obtain a forbearance by submitting a forbearance request to the loan servicer along with an affirmation that the requester is experiencing financial hardship during the COVID-19 emergency. Upon receiving this request and affirmation of hardship, and irrespective of the delinquency status of the loan, the servicer must provide a forbearance of up to 180 days, which may be extended for an additional 180 days at the borrower's request, and the servicer may not require any additional information to be submitted or impose any fees, penalties, or interest in connection with the forbearance request. During the forbearance period, no fees, penalties, or interest may accrue on the borrower's account beyond those scheduled or calculated as if the borrower had made all contractual payments on time and in full as required by the terms of the mortgage. On April 27, 2020, the Federal Finance Housing Agency, the regulator of Fannie Mae and Freddie Mac, clarified that borrowers would not be required to repay the skipped payments in a lump sum, but rather could do so over time.
    - Forbearances may be requested during the "covered period," which, unlike in other sections of the Act that use the term, is not defined in Section 4022. However, based on the Senate's summary of the provision, it appears that the intent was to apply the same definition as used in Section 4023, which would mean that forbearances must be requested by the earlier of (i) the end of the national COVID-19 emergency or (ii) December 31, 2020. A request for a forbearance extension must be made by the borrower prior to the end of the initial forbearance period, and borrowers may request to shorten a forbearance period at any time. It is unclear from the text whether an extension request must be made within the undefined "covered period," although if interpreted consistent with the provisions of Section 4023, the answer would be "yes."
    - *Foreclosure Moratorium*. Section 4022 also imposes a foreclosure moratorium that prohibits "a servicer of a Federally backed mortgage loan" from initiating any foreclosure process, moving for a foreclosure judgement or order of sale, or executing any foreclosure-related eviction or foreclosure sale for not less than the 60-day period commencing on March 18, 2020. The prohibition applies to both judicial and non-judicial foreclosures. While not expressly stating so, presumably the restriction applies only to foreclosures related to Federally backed mortgage loans.
- **Eviction Moratorium**: Beginning on March 27, 2020, Section 4024 imposes a 120-day moratorium on eviction proceedings and prohibits certain fees and penalties against tenants residing in properties with federally related mortgages. Specifically, landlords of properties that have a Federally backed mortgage loan or a Federally backed multifamily mortgage loan (see discussions of Sections 4022 and 4023 for

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

relevant definitions), or that participate in the federal Violence Against Women Act or the rural housing voucher programs, may not commence eviction proceedings against tenants in such properties for nonpayment of rent or of other fees or charges. Such landlords are also prohibited during the moratorium from assessing tenants any fees, penalties, or other charges for nonpayment of rent. Additionally, covered landlords may not provide a tenant with a notice to vacate until the expiration of the 120-day moratorium, and then must give tenants at least 30 days from the date of the notice in which to vacate the property.

- **Multifamily Loan Forbearance**: Section 4023 of the Act establishes a forbearance program for multifamily mortgage loan borrowers experiencing financial hardship as a result of COVID-19. Any "multifamily borrower" with a "Federally backed multifamily mortgage loan" that experiences a financial hardship during the COVID-19 emergency may request a forbearance. A "multifamily borrower" is a borrower of a residential mortgage loan that is secured by a lien against a property comprising five or more dwelling units. "Federally backed multifamily mortgage loans" include loans that are secured by a first or subordinate lien on residential multifamily (5+) real property and that are insured, assisted, or purchased by Fannie Mae, Freddie Mac, or HUD.

Requests for forbearance must be made during the covered period, which began with the enactment of the Act and continues until the earlier of (i) the end of the national COVID-19 emergency, or (ii) December 31, 2020. The forbearance will last for an initial period of 30 days and, at the request of the borrower, may be extended for up to two additional 30-day periods, provided that the request is made during the covered period and at least 15 days prior to the end of the current forbearance period. Borrowers may discontinue a forbearance period at any time. To request a forbearance, a borrower must have been current on the loan as of February 1, 2020, and must submit an oral or written request for forbearance to the loan servicer affirming that the requester is experiencing a financial hardship during the COVID-19 emergency.

If granted a forbearance, a multifamily borrower must extend certain renter protections to the tenants of the multifamily property to which the loan relates. Specifically, borrowers who receive a forbearance under Section 4023 are prohibited, during the forbearance period, from: (i) evicting or initiating the eviction of any tenant solely for nonpayment of rent or of other fees or charges; (ii) charging any late fees, penalties, or other charges to a tenant for late payment of rent; or (iii) issuing a notice to vacate to a tenant. Once a borrower does issue a notice to vacate to a tenant, the tenant must be given at least 30 days to vacate.

EXECUTIVE BRANCH ACTIVITY

Actions to Facilitate Lending and Liquidity: The Federal Reserve has taken several actions to stabilize the economy, including using its emergency lending authority to establish broadly based facilities to lend to financial institutions and eligible US businesses and shore up liquidity in the markets. Among its actions to date in its role as the US Central Bank, the Federal Reserve has (1) reduced the federal funds rate to 0% to 25%; (2) agreed to purchase an unlimited amount of Treasury securities and agency mortgage-backed securities (MBSs), including agency commercial MBSs, to support smooth market functioning and effective transmission of monetary policy; (3) established three lending facilities under a Main Street Lending Program to complement efforts by the SBA and support lending to eligible small and medium-sized businesses; (4) established a lending facility to facilitate lending to small businesses under the SBA's PPP by providing term financing backed by PPP loans to financial institutions that are PPP lenders; and (5) established other liquidity facilities similar to those established under the 2008 Financial Crisis, including facilities that allow eligible borrowers to restructure their loans generally using investment grade collateral.

The new facilities are summarized below. In the interest of transparency and accountability around financial reporting and policymaking, the Federal Reserve has stated that it will provide monthly public reports on its liquidity and lending facilities that use CARES Act funding, and the reports will contain substantial amounts of information, including (i) names and details of participants in each facility; (ii) amounts borrowed and interest

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

rates charged; (iii) overall costs, revenues and fees for each facility. The Federal Reserve has also made it clear that it is prepared to use the full range of tools at its disposal to support the flow of credit to businesses and consumers in furtherance of its goals of maximum employment and price stability.

- **Primary Market Corporate Credit Facility (PMCCF)**: Under this facility, the Federal Reserve will (i) purchase eligible corporate bonds as the sole investor in a bond issuance: and (ii) purchase portions of syndicated loans or bonds at issuance. The Department of the Treasury will make a $75 billion equity investment to support both the PMCCF and the Secondary Market Corporate Credit Facility (SMCCF) described below. The initial equity allocation will be $50 billion to the PMCCF and $25 billion to the SMCCF. The combined size of the two Facilities will be up to $750 billion. Corporate bonds eligible for purchase by the PMCCF as sole purchaser must be issued by and eligible issuer and have a maturity of four years or less. PMCCF purchases of portions of syndicated loans and bonds are subject to the same requirements. In addition, the PMCCF cannot purchase more than 25% of any issuance of syndicated loans and bonds. An eligible issuer is a business that is created or organized in the US or under the laws of the US with significant operations in and a majority of its employees based in the US. Businesses using this facility must have investment-grade credit (rated BBB-/Baa3 or higher) as of March 22, 2020. Issuers rated at least BBB-/Baa3 as of March 22, 2020 but are subsequently downgraded must be rated at least BB-/Ba3 at the time the PMCCF makes a purchase. In every case, issuer ratings are subject to Federal Reserve review.

  Under the PMCCF, the issuer may not be an insured depository institution or depository institution holding company, as those terms are defined in the Dodd-Frank Act, and cannot have received any specific support pursuant to the CARES Act or any subsequent federal legislation. In addition, the issuer must satisfy the conflicts-of-interest requirements of Section 4019 of the CARES Act (none of the President, Vice President, executive department head, member of Congress, or their immediate families may own over 20% or more of the equity of an entity). The maximum amount of outstanding bonds or loans of an eligible issuer that borrows from the PMCCF may not exceed 130% of the issuer's maximum outstanding bonds and loans on any day between March 22, 2019 and March 20, 2020. The maximum amount of instruments that the PMCCF and the SMCCF combined may purchase with respect to any eligible issuer is capped at 1.5% of the combined potential size of the two facilities. The PMCCF will cease purchasing eligible assets no later than September 30, 2020, unless the Facility is extended by the Federal Reserve and the Treasury Department. See term sheet here.

- **Secondary Market Corporate Credit Facility (SMCCF)**: The SMCCF is intended to provide liquidity to existing bondholders. The SMCCF will purchase in the secondary market individual eligible corporate bonds and eligible corporate bond portfolios in the form of exchange-traded funds (ETFs). The Treasury Department will make an equity investment as described in the PMCCF analysis above. The SMCCF may purchase corporate bonds issued by an eligible issuer, have a remaining maturity of five years or less, and were sold to the SMCCF by an eligible seller. The requirements to qualify as an eligible issuer are substantially the same as those to qualify under the PMCCF, as described above. In order to qualify as an eligible seller, the institution must be a business that is created or organized in the US or under the laws of the US, with significant US operations and a majority of US-based employees. The institutions also must satisfy the conflicts-of-interest requirements of Section 4019 of the CARES Act described above. The SMCCF may also purchase certain US-listed ETFs whose investment objective is to provide broad exposure to the market for US corporate bonds. The preponderance of ETF holdings will be ETFs whose primary investment objective is exposure to US investment-grade corporate bonds, with the remainder in ETFs whose primary investment objective is exposure to US high-yield corporate bonds. The maximum amount of bonds of any single issuer that the SMCCF will purchase from the secondary market is capped at 10% of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020, and the SMCCF will not purchase any shares of a particular ETF if the purchase would result in the Facility holding more than 20% of the ETF's outstanding shares. The SMCCF commenced its purchase of ETFs on May 12, 2020. The SMCCF will cease purchasing eligible corporate bonds and ETFs no later

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

than September 30, 2020, unless the SMCCF is extended by the Federal Reserve and the Treasury Department. See term sheet here.

- **Term Asset-Backed Securities Loan Facility (TALF)**: Under this Facility, the Federal Reserve Bank of New York (New York Fed) will initially make available, through a special-purpose vehicle, up to $100 billion of loans to eligible borrowers. This lending will be supported by an equity investment of $10 billion by the Treasury Department. The loans will have a 3-year term, will be nonrecourse to the borrower, and will be fully secured by eligible asset-backed securities (ABS). All US companies that own eligible collateral and maintain an account relationship with a primary dealer are eligible to participate. US company is defined as a business created or organized in the US or under the laws of the US that has significant operations in and a majority of its employees based in the US (generally determined on a consolidated basis, but taking into account only downstream affiliates, not parent or sister entities) and includes investment funds. ABS that will be viewed as eligible collateral are those that have underlying exposures to the following: automobile loans and leases, student loans, credit card receivables, equipment loans and leases, floorplan loans, insurance premium finance loans, certain SBA-guaranteed small business loans, leveraged loans, and commercial mortgages. With the exception of commercial mortgage-backed securities (CMBS), eligible ABS must be issued on or after March 23, 2020. Only CMBS issued before March 23, 2020 will be eligible for this Facility. Also, for \ CMBS to be eligible, the underlying credit exposures must be to real property located in the US or one of its territories. Eligible collateral does not include asset-backed securities that bear interest payments that step up or step down to predetermined levels, or that include exposures that are cash ABS or synthetic ABS. Eligible borrowers and issuers of eligible collateral will be subject to the conflicts-of-interest requirements of Section 4019 of the CARES Act described above. On May 12, 2020, the New York Fed released an updated Term Sheet, along with a list of Frequently Asked Questions (FAQs). Non-static CLOs, and ABS backed by unsecured consumer loans remain ineligible under the revised guidance. The New York Fed also announced on May 12th that it will disclose, on a monthly basis, the name of each TALF participant; the amounts borrowed, interest rate charged, and value of pledged collateral; and the overall costs, revenues, and fees for the Facility.
- **Money Market Mutual Fund Liquidity Facility (MMLF)**: Under this facility, the Federal Reserve will lend to US depository institutions, US bank holding companies (and their US broker-dealer subsidiaries), and US branches and agencies of foreign banks. Eligible collateral will be limited to certain types of assets purchased by the borrower from a money market fund. The types of assets that may serve as eligible collateral include US Treasuries and Fully Guaranteed Government Securities, securities issued by the Government Sponsored Enterprises, highly-rated municipal short-term debt, and secured and unsecured commercial paper. No new credit extensions will be made after September 30, 2020, unless the facility is extended by the Federal Reserve. On March 23, 2020, the bank regulatory agencies adopted an interim final rule to neutralize the regulatory capital effects of banking organizations participating in the program. See term sheet here. On May 12, 2020, the FDIC issued a Notice of Proposed Rulemaking to mitigate the deposit insurance assessment effects of participating in the MMLF and the PPPL, with a proposed effective date by June 30, 2020 and an application date of April 1, 2020, in order to cover the second quarter of the year.
- **Municipal Liquidity Facility (MLF)**: The MLF will provide funding and liquidity directly to state and local governments. The MLF will purchase Eligible Notes from Eligible Issuers at the time of issuance. Originally, Eligible Notes were certain short-term notes with maturities not to exceed 24 months issued by Eligible Issuers, and Eligible Issuers included US states and the District of Columbia, US cities with a population exceeding 1 million residents, and US counties with a population exceeding 2 million residents. On April 27, the Federal Reserve revised the terms of the MLF to increase the maximum maturity to 36 months and decrease the population thresholds for cities and counties to 250,000 and 500,000, respectively. The Treasury Department will make an initial equity investment of $35 billion and the MLF have the ability to purchase up to $500 billion of Eligible Notes. Under the revised terms, the MLF will

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

cease purchasing Eligible Notes on December 31, 2020, unless the Federal Reserve and the Treasury Department extend the Facility. See revised term sheet here.

- **Commercial Paper Funding Facility (CPFF)**: This facility is structured as a credit facility to a special purpose vehicle (SPV), and the SPV will serve as a funding backstop to facilitate the issuance of term commercial paper by eligible issuers. The SPV will purchase investment-grade 3-month dollar-denominated commercial paper from eligible US issuers (including US issuers with a foreign parent company). The SPV will cease purchasing commercial paper on March 17, 2021, unless the Federal Reserve extends the facility. The New York Fed will continue to fund the SPV until its underlying assets mature. See term sheet here.
- **FIMA Repo Facility:** This is a temporary repurchase agreement facility for foreign and international monetary authorities to help the smooth functioning of financial markets, including the US Treasury market. Under the FIMA Repo Facility, FIMA account holders (i.e., central banks and other international monetary authorities with accounts at the New York Fed) will be able to enter into repurchase agreements with the Federal Reserve, whereby the FIMA account holder temporary exchanges their US Treasury securities for US dollars. See FAQs here.

  Note that the Federal Reserve, along with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank have agreed to coordinate actions to further enhance the provision of US dollar liquidity. These central banks have agreed to increase the frequency of 7-day maturity operations from weekly to daily. The operations began on March 23, 2020, and are expected to continue at least through the end of April. The swap lines among these central banks serve as an important liquidity backstop to ease strains on global funding markets, and thereby help mitigate the effects of such strains on the supply of credit to households and businesses domestically and abroad.
- **Primary Dealer Credit Facility (PDCF):** This facility will allow primary dealers to support smooth market functioning and facilitate the availability of credit to businesses and households by offering overnight and term funding with maturities up to 90 days. Eligible collateral for primary dealers includes a broad range of investment grade debt securities, including commercial paper, municipal bonds and equity securities. This facility will be available until September 2020, unless economic conditions warrant a longer availability. See term sheet here.
- **PPP Loan Financing Facility.** On April 6, 2020 Federal Reserve announced a new facility, the Paycheck Protection Program Liquidity Facility (PPPLF), that will facilitate lending to small businesses via the PPP by providing term financing backed by PPP loans. Many nonbank SBA lenders do not have sufficiently large balance sheets to carry the volume of PPP loans they expect to originate, and there is not currently a functioning secondary market in PPP loans (although one may develop). This facility is intended to bridge that funding shortfall by permitting lenders to obtain financing from the Federal Reserve of their PPP loans, taking the loans as collateral at face value. On April 9, 2020, the Federal Reserve released a term sheet describing the terms of the PPPLF. See PPPLF term sheet here. Also, as described above in the summary of the PPP program, the federal banking agencies have provided specific capital relief in connection with PPP lending. On May 12, 2020, the Federal Reserve announced that it will disclose, on a monthly basis, the name of each PPPLF participant; the amounts borrowed, interest rate charged, and value of pledged collateral; and the overall costs, revenues, and fees for the Facility. Also On May 12, 2020, the FDIC issued a Notice of Proposed Rulemaking to mitigate the deposit insurance assessment effects of participating in the MMLF and the PPPL, as described above under **Municipal Liquidity Facility (MLF)**.
- **Main Street Lending Program (MSNLF, MSELF, and MSPLF)**: On April 9, 2020, the Federal Reserve announced the terms of a Main Street New Loan Facility (MSNLF) and a Main Street Expanded Loan Facility (MSELF) to implement its Main Street Lending Program. On April 30, 2020, the Federal Reserve expanded the scope and eligibility of businesses that may participate in these facilities and announced the creation of a third facility, the Main Street Priority Loan Facility (MSPLF).

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

Under the MSNLF, MSELF and MSPLF, "eligible lenders" are U.S.-insured depository institutions (including banks, savings associations and credit unions), U.S. branches and agencies of foreign banks, U.S. bank and savings and loan holding companies, U.S. intermediate holding companies of foreign banking organizations, and U.S. subsidiaries of any of the foregoing. "Eligible borrowers" are businesses created in the U.S. or under the laws of the U.S. (prior to March 13, 2020) with significant operations and a majority of its employees in the U.S. Additionally, borrowers must meet either an employee or an annual revenue threshold: (i) 15,000 or less employees, or (ii) no more than $5 billion in 2019 annual revenue. Prior to the April 30th expansion of the program, the limits for employees and annual revenue were 10,000 and $2.5 billion, respectively. As part of the April 30th changes, the Federal Reserve added to the borrower eligibility criteria that borrowers must not have received specific support under Subtitle A of Title IV of the CARES Act, but notes that this restriction does not prohibit businesses that have received PPP loans, provided that the business is otherwise an eligible borrower. Another eligibility requirement for borrowers is that the borrower is not of the type of entity that is ineligible for an SBA loan under 13 CFR 120.110(b)-(j) and (m)-(s) (citation excludes nonprofits and religious institutions) as modified by regulations for the PPP. However, the Federal Reserve notes that the application of this restriction may be further modified at the agency's discretion. The combined size of the MSNLF, MSELF, and MSPLF will be up to $600 billion. The Treasury Department will make a $75 billion equity investment using CARES Act funds. Borrowers may only participate in one of the three Main Street Lending Program facilities, and borrowers of the MSNLF, MSELF, or MSPLF may not participate in the PMCCF.

Under both the MSNLF and the MSELF, the Federal Reserve through a special purpose vehicle ("SPV") will purchase 95% participations in eligible loans from eligible lenders, with the eligible lenders retaining the remaining 5%. The 5% is viewed as a risk retention component of the loan. Under the MSPLF, which is for new loans to businesses with higher leverage amounts than those eligible for the MSNLF, the SPV will purchase 85% participations in eligible loans, and lenders will be expected to retain the remaining 15%. According to the FAQs released on April 30th, the eligible lender would be required to retain its participation interest until the applicable loan matures or the SPV sells off all of its participation, whichever comes first.

Under all three facilities, "eligible loans" are secured or unsecured term loans made by an "eligible lender" that have: (i) a 4-year maturity; (ii) principal and interest payments deferred for one year (but with accrued and interest added to principal); and (iii) interest accrued at an adjustable rate of LIBOR plus 3% (prior to the April 30th changes, the rate was SOFR plus 250-400 basis points).

Under the lending facilities for loans originated after April 24, 2020 (i.e. MSNLF and MSPLF), the minimum loan size is now $500,000 (reduced from $1 million minimum that was set previously for the MSNLF), and the maximum loan size is the lesser of (i) $25 million, or (ii) an amount that, when added with the eligible borrower's existing outstanding and committed but undrawn debt does not exceed four times the eligible borrower's 2019 adjusted EBITDA for the MSNLF, or six times the eligible borrower's 2019 adjusted EBITDA for the MSPLF. Aside from the difference in leverage thresholds, the MSNLF and MSPLF have different criteria for the priority of eligible loans under each facility. Under the MSNLF, at the time of origination or at any time during the loan term, eligible loans must not be contractually subordinated in terms of priority to any other loans or debt instruments of the eligible borrower. Eligible loans under the MSPLF at the time of origination and at all times thereafter must be senior to or pari passu with, in terms of priority and security with any other loans or debt instruments of the eligible borrower, other than mortgage debt.

Loans from eligible lenders to eligible borrowers that were originated on or before April 24, 2020 may qualify for "upsizing" pursuant to the MSNLF, so long as the underlying loan has a maturity (taking into account any extensions at or prior to upsizing) of at least 18 months. Under the MSNLF, eligible lenders are able to increase an eligible borrower's existing term loan or revolving credit facility with the eligible lender, whether secured or unsecured, by adding a new tranche. The upsized tranche is a four-year term loan ranging in size from $10 million to $200 million (increased from $150 million under the April 30th

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

expansion of the Main Street Lending Program). The maximum loan size for any eligible borrower may not, however, be greater than the lesser of (i) 35% (increased from 30% under the April 30 expansion) of the eligible borrower's existing outstanding and committed but undrawn debt that is pari passu in priority with the eligible loan and equivalent in secured status, or (ii) an amount that, when added to the eligible borrower's existing and outstanding and committed but undrawn debt does not exceed six times the eligible borrower's adjusted 2019 EBITDA. At the time of upsizing and at all times thereafter the upsized tranche must be senior to or pari passu with, in terms of priority and security, the eligible borrower's other loans or debt instruments, other than mortgage debt.

Below is a chart summarizing the loan options under each of the Main Street Lending Program facilities.

Main Street Lending Program Loan Options	New Loans (MSNLF)	Priority Loans (MSPLF)	Expanded Loans (MSELF)
Term	4 years	4 years	4 years
Minimum Loan Size	$500,000	$500,000	$10,000,000
Maximum Loan Size	Lesser of $25M or 4x 2019 adjusted EBITDA	Lesser of $25M or 6x 2019 adjusted EBITDA	Lesser of $200M, 35% of outstanding and undrawn available debt, or 6x 2019 adjusted EBITDA
Risk Retention	5%	15%	5%
Payment (year one deferred for all)	Years 2-4: 33.33% each year	Years 2-4: 15%, 15%, 70%	Years 2-4: 15%, 15%, 70%
Rate	LIBOR + 3%	LIBOR + 3%	LIBOR + 3%

Under all three of the facilities, eligible borrowers and eligible lenders are required to provide a number of certifications and commitments to the Federal Reserve, including (i) that loan proceeds will not be used to pay existing debt (except that, under the MSPLF, the proceeds may be used to refinance debt owed to a lender that is not the eligible lender providing the MSPLF loan), (ii) the eligible borrower will not prepay other debt until the new loan (or upsize tranche) is paid in full, and (iii) eligible borrowers will be able to meet financial obligations for at least 90 days and do not expect to file for bankruptcy during the time period of the loan. Significantly, the MSNLF, MSELF, and MSPLF all require an eligible borrower under each facility to attest that it will follow the compensation, stock repurchase and capital distribution restrictions applicable to direct loan programs under section 4003(c)(3)(A)(iii)of the CARES Act. Additionally, both eligible lenders and eligible borrowers must certify that their entity is able to participate in the respective facility, including that it is in compliance with conflicts-of-interest prohibitions in section 4019(b) of the CARES Act. Term sheets describing the MSNLF, MSELF and MSPLF as well as FAQs about the Main Street Lending Program can be found here. A more detailed update of the program terms can be found here.

- **Actions to Temporarily Ease Regulatory Requirements on Lenders:** The federal banking agencies have issued statements and guidance and implemented rule changes to encourage financial institutions to continue lending and assisting individual and business customers impacted by COVID-19. Notable actions include:

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- Discount Window: On March 15, a Sunday, the Federal Reserve announced it was lowering the targeted federal funds rate to 0.0% to 0.25%. Simultaneously, the Federal Reserve slashed the primary credit rate (the discount window rate for the most sound depository institutions seeking to borrow from the central bank) 150 basis points to 0.25%. Traditionally, there has been stigma associated with borrowing from the discount window as it may signal that a bank is unable to obtain a lower rate from another bank (hence the Fed's "lender of last resort" moniker). By setting the primary credit rate close to the federal funds target rate, the Federal Reserve is attempting to remove that stigma and encourage banks to use the discount window in order to ensure that there is a sufficient flow of credit from banks to households and businesses. The Federal Reserve also extended the length of the loans from overnight to 90 days. The next day, March 16, the federal banking agencies released an interagency statement jointly encouraging banks to borrow from the discount window. The same day, eight of the nation's largest banks borrowed from the discount window to help reduce the stigma of doing so, according to news reports. For the week ending March 25, 2020, banks had borrowed over $50 billion from the discount window, the most since April 2009.
- Use of Capital and Liquidity Buffers: Also on March 15, the Federal Reserve took the first of several steps, as discussed below, to encourage banks to use their capital and liquidity buffers to lend to households and businesses impacted by COVID-19. Since the 2008 financial crisis, the federal banking agencies have directed banks to significantly increase their capital and liquidity requirements in an effort to support the economy and consumers in a future economic downturn. The Federal Reserve essentially announced that the time for financial institutions to dip into its loss-absorbing capital is now.
- Regulatory Capital Relief: On March 17, the federal banking agencies issued an interim final rule revising the definition of eligible retained income for financial institutions subject to the capital rule. Under the capital rule, financial institutions are required to maintain a minimum amount of regulatory capital plus a buffer of regulatory capital above those requirements in order to encourage capital conservation and limit capital distributions and discretionary bonus payouts. Given that capital ratios are likely to decrease significantly—indeed the federal banking agencies are encouraging financial institutions to use their capital and liquidity buffers for increased lending—financial institutions likely will experience "sudden and severe" limitations on capital distributions. The interim final rule amends the definition of retained income in order to make such limitations more gradual. Also, as described above in the descriptions of the PPP and the MMLF , the federal banking agencies have provided specific capital relief in connection with lending related to those programs.
- TLAC Relief: Similarly, on March 23, the Federal Reserve announced an interim final rule that is intended to gradually phase in automatic limitations on capital distributions should a firm's required total loss-absorbing capacity (TLAC) buffer levels decline.
- Supplementary Leverage Ratio: On April 1, the Federal Reserve adopted an interim final rule allowing bank holding companies, savings and loan holding companies, and intermediate holding companies subject to the supplementary leverage ratio (SLR) (generally, those institutions with more than $250 billion in consolidated assets) to exclude Treasuries and deposits held at Federal Reserve Banks from the SLR calculation through March 31, 2021. Ordinarily, these large financial institutions must maintain Tier 1 capital (primarily retained earnings and common stock) equal to at least 3% of their total leverage exposure. Total leverage exposure includes all on-balance sheet assets, including US Treasuries and deposits and deposits at Federal Reserve Bank. The result is that, as balance sheets are expanding with the market liquidating assets and depositing cash with financial institutions, lending may be constrained by the requirement to hold more Tier 1 capital. The temporary exclusion of ultra-safe assets (Treasuries, central bank deposits) from the calculation is intended to encourage financial institutions to continue lending to households and

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

businesses as their balance sheets are rapidly growing. The move is also intended to ease the strains on the Treasury markets, in which liquidity has deteriorated significantly.

It is important to note, however, that the FDIC and OCC have not yet issued a similar rule change. As a result, while a large bank holding company's capital requirements have been lowered, its FDIC- or OCC-regulated bank subsidiary's capital requirements remain unchanged. The FDIC and OCC evidently are still considering implementing a rule change consistent with the Federal Reserve's new rule.

- Encouraging Accommodations for Customers Impacted by COVID-19: On March 9, the federal financial institution regulators and state banking supervisors issued a statement encouraging financial institutions to work constructively and prudently with borrowers impacted by COVID-19 to meet the borrowers' financial needs. On March 13, 2020, the Federal Reserve followed this announcement by referring supervised financial institutions to SR 13-6 / CA 13-3, its guidance from 2013 regarding supervisory practices during a major disaster or emergency. This SR letter encourages financial institutions to consider the following efforts during a major disaster or national emergency:

  - Waiving ATM, overdraft, and late fees, as well as early withdrawal penalties on time deposits;
  - Increasing ATM daily cash withdrawal limits;
  - Easing credit terms for new loans;
  - Increasing credit limits for creditworthy customers;
  - Offering payment accommodations such as allowing loan customers to defer or skip some payments or extending payment due dates, which would avoid delinquencies and negative credit bureau reporting caused by disaster-related disruptions; and
  - Conducting a review of an affected borrower's financial condition in an effort to implement a prudent loan workout arrangement.

The Federal Reserve states that it will not criticize a banking organization that implements prudent loan workouts for affected customers even if the restructured loans result in adverse classifications or credit risk downgrades. The FDIC and OCC issued nearly identical guidance on March 13, 2020. A further update to this guidance was jointly issued by federal and state bank regulators on April 7, 2020.

- Small-Dollar Lending: In a similar move, the federal banking agencies, CFPB, and NCUA issued a statement on March 26 specifically encouraging financial institutions to offer responsible small-dollar loans to consumers and small businesses in the form of open-end lines of credit, closed-end installment loans, or single-payment loans. Consistent with their earlier statements in March, the agencies encouraged financial institutions to consider workout strategies for borrowers unable to repay.

- CRA Consideration for Activities in Response to COVID-19: On March 19, 2020, the federal banking agencies issued a joint statement that specifically encouraged financial institutions to work with low- and moderate-income customers and communities impacted by COVID-19. The agencies announced that, for Community Reinvestment Act (CRA) purposes, they will favorably consider retail banking services and retail lending activities that are responsive to the needs of low- and moderate-income individuals, small businesses, and small farms affected by COVID-19. Services and activities that will result in favorable consideration are those that are identified in SR 13-6 / CA 13-3. The joint statement reaffirms the Federal Reserve's commitment in SR 13-6 / CA 13-3 that a financial institution's effort to modify terms of new or existing loans for affected low- and moderate-income customers will not be subject to examiner criticism. The agencies also clarified that financial institutions will receive CRA consideration for community development activities such as lending or making investments to support access to health care, food supplies, and services for low- and moderate-income individuals and communities.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- Relief for Mortgage Servicers. On April 3, the federal banking agencies, along with the CFPB, the NCUA, and the Conference of State Bank Supervisors, issued a joint statement encouraging mortgage servicers to offer short-term forbearance and repayment plans to borrowers facing hardships related to the COVID-19 crisis. To ensure that mortgage servicers have the capacity to engage in the offering of such services, the joint statement provides that the agencies will adopt a flexible supervisory and enforcement approach in respect of certain consumer communication and other compliance requirements set forth under the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X. Among other things, the joint statement provides that a CARES Act-required forbearance qualifies as a "short-term payment forbearance program" under Regulation X and therefore is excluded from certain loss mitigation requirements set forth thereunder and that the agencies will not take supervisory or enforcement action against servicers for failure during the ongoing emergency to provide certain notices that are required by regulation in a timely manner.

- Troubled Debt Restructuring Guidance: The federal banking agencies issued guidance on March 22, 2020 related to troubled debt restructurings (TDRs). The agencies reiterated their encouragement of financial institutions to work with borrowers unable to meet loan obligations in light of COVID-19, and specifically supported loan modification programs as "positive actions." Ordinarily, under GAAP, a creditor's modification of a loan to accommodate the debtor's financial difficulties would constitute a TDR. The agencies confirmed with the Financial Accounting Standards Board (FASB) that good-faith, short-term modifications in response to COVID-19 for borrowers who were current (less than 30 days past due) prior to the modification do not constitute TDRs. These include modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other "insignificant" delays in payment. Generally business decisions made related to debt restructured in connection with COVID-19 will not receive heightened regulatory scrutiny by examiners. Specifically, examiners will not automatically adversely risk rate credits affected by COVID-19, including those considered to be TDRs. Generally, examiners "will not criticize prudent efforts to modify the terms on existing loans to affected customers." This scaled-back supervisory scrutiny should give banks more leeway to avoid treating all loans restructured in connection with COVID-19 as TDRs for accounting purposes.

- Liberalizing Rules on Savings Account Withdrawals: On April 24, The Federal Reserve announced an interim final rule to amend Regulation D (Reserve Requirements of Depository Institutions) (12 CFR Part 204) to delete the six-per-month limit on convenient transfers from the "savings deposit" definition (which includes money market deposit accounts (MMDAs). The interim final rule allows depository institutions immediately to suspend enforcement of the six transfer limit and to allow their customers to make an unlimited number of convenient transfers and withdrawals from their savings deposits at a time when financial events associated with the coronavirus pandemic have made such access more urgent. Although adopted to address the current situation, it appears that this amendment may be permanent.

- Temporary Changes to Branch Operations and Facilities: On March 13 the Federal Reserve,[3] FDIC, and OCC announced they would be accommodating when financial institutions seek to alter their service options, recognizing that branches may need to close, relocate operations, or operate on significantly reduced capacity. Each agency encourages financial institutions to promptly contact their federal and state supervisors (as well as customers) about temporary branch closures and the availability of alternative service options. The Federal Reserve will not require an application for temporary closings or relocations necessitated by COVID-19. The FDIC, in conjunction with the state supervisor, will expedite requests to operate temporary facilities. In most cases, a telephone request will suffice to start the approval process, with written notification to be submitted shortly thereafter.

[3] On March 13, 2020 the Federal Reserve issued an SR letter referring financial institutions to its previous guidance on national emergencies contained in SR 13-6 / CA 13-3.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- Scaling Back Non-Essential Examinations: On March 24, 2020, the Federal Reserve issued a statement announcing significant changes to its supervisory priorities during the pandemic in order to minimize disruption and burden on financial institutions and to focus on monitoring operations. These changes include:

    - Supervisors will focus on monitoring operations, liquidity, asset quality and consumer impact at all firms. At larger firms, supervisors will also focus on operational resiliency and broader impacts on the financial system.
    - All examination activities will be conducted off-site until normal operations are resumed at the bank and Reserve Banks.
    - For supervised institutions with less than $100 billion in total consolidated assets, the Federal Reserve generally will cease all regular examination activity, except when it is critical to safety and soundness or consumer protection, or to address an urgent need.
    - For supervised institutions with greater than $100 billion in total consolidated assets, the Federal Reserve intends to defer a significant portion of planned examination activity.
    - A financial institution may, however, receive an examination report from a recently completed or nearly complete examination. The Federal Reserve is extending remediation deadlines by 90 days unless an earlier remediation would address a heightened risk or aid consumers. Generally, supervisors are supposed to ensure all supervisory findings are "still relevant and appropriately prioritized in light of changing circumstances."
    - On May 8, 2020, Federal Reserve indicated in its annual report on regulatory developments that it has deferred or canceled "non-critical" examinations and that any exam activity through the end of the year will focus on the impacts of COVID-19 or issues that predate the pandemic.

  For those bank holding companies and intermediate holding companies of foreign banking organizations that are required to complete the Comprehensive Capital Analysis and Review (CCAR) exercise, plans still had to have been submitted by April 6, 2020. The plans will be used by the supervisors to monitor how firms are managing capital in the current environment, planning for contingencies and positioning themselves to continue lending.

- Regulation W Relief: The Federal Reserve recently issued a waiver of the limitations under Section 23A of the Federal Reserve Act and Regulation W in order to allow certain banks to purchase certain assets from affiliated broker-dealers and money market funds.

- Liquidity Relief: On May 5, 2020, the federal banking agencies released an interim final rule that modifies the agencies' Liquidity Coverage Ratio (LCR) rule to support banking organizations' participation in the MMMLF and the PPPLF by neutralizing the LCR impact associated with the non-recourse funding provided by these Facilities.

For more information on efforts by the federal banking regulators, see our Advisory, "Financial Regulators Encourage and Expect Firms to Continue Assisting Businesses During the Coronavirus Pandemic."

Standardized Approach to Counterparty Credit Risk in Derivatives Contracts: On March 31, the federal banking agencies issued a notice providing that banking organizations are permitted to implement the Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (SA-CCR) in the first quarter of 2020—one quarter earlier that the SA-CCR final rule had provided originally. The SA-CCR establishes a more risk-sensitive methodology for calculating the exposure amounts of derivative contracts under the regulatory capital rules. The allowance of early adoption of the SA-CCR is intended to promote liquidity and smooth disruptions in the financial markets related to the COVID-19 crisis.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

Guidance on Business Preparedness: On March 6, the Federal Financial Institution Examination Council (FFIEC), which is comprised of the Federal Reserve, the FDIC, the OCC, the NCUA, and the CFPB, updated its guidance related to the development of a business continuity plan (BCP) to include additional considerations related to pandemic planning (FFIEC Guidance).

The FFIEC Guidance emphasizes that pandemic planning is different and arguably more challenging than traditional business continuity planning because, among other reasons, pandemics are widespread, may occur in multiple waves over time, and can cause more significant staffing shortages that pose challenges to executing that portion of a BCP. Accordingly, the FFIEC Guidance identifies actions beyond a traditional BCP to address such unique challenges. Specifically, a financial institution's planning should provide for:

- A preventative program (including monitoring of potential outbreaks, educating employees, providing appropriate hygiene training and tools, and coordinating with critical service providers);
- A documented strategy that provides for scaling the institution's pandemic efforts to be consistent with the effects of a particular stage of a pandemic outbreak (e.g., the Centers for Disease Control and Prevention);
- A comprehensive framework of facilities, systems, or procedures that provide the firm with the capability to continue critical operations during prolonged staff shortages;
- A testing program to ensure that the planning practices and capabilities are effective and will allow critical operations to continue; and
- An oversight program to ensure ongoing review and updates.

The FFIEC Guidance notes that the potential impact of a pandemic on the delivery of critical financial services should be incorporated into the ongoing business impact analysis and risk assessment processes. The agencies remind financial institutions that considerations of a traditional BCP remain relevant in the time of a pandemic, including risk assessment, monitoring and testing.

The Financial Industry Regulatory Authority (FINRA) has issued similar business continuity guidance for securities firms. The SEC also issued guidance on its COVID-19 response plan, which noted that the SEC is prepared to provide regulatory relief and guidance to registered investment advisers and broker-dealers in connection with the execution of their BCPs.

Reporting and Other Forms of Regulatory Relief: The federal banking agencies, under the auspices of the FFIEC, issued a statement on March 25, 2020 recognizing that financial institutions may need additional time to submit certain regulatory reports, and that the agencies will not take action against any institution for submitting, in good faith, its March 31, 2020 Call Reports after the official deadline, as long as it is submitted within 30 days after the deadline. In addition, the FDIC issued a statement announcing that it will accept late filing of annual reports required under Part 363 of the FDIC's regulations upon the submission of written notification of such late filing.

FINRA has temporarily suspended its requirement that firms maintain updated Form U4 information regarding office of employment for registered persons who temporarily relocate due to COVID-19 reasons. Also, member firms currently are not required to submit branch office applications on Form BR for any newly opened temporary office established due to COVID-19. Regarding other filings and responses to regulatory inquires, member firms are encouraged to contact the relevant FINRA department to seek an extension, if necessary. FINRA's website, which includes all related FINRA guidance, notices, and rules related to operations during the COVID-19 pandemic, may be found here.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

The SEC has issued numerous statements, guidance, and exemptive orders providing targeted regulatory relief. For example, the SEC has provided:

- Conditional regulatory relief for certain publicly traded company filing obligations under the federal securities laws. Specifically, the SEC is providing companies impacted by COVID-19 the opportunity to request additional time (up to 45 days) to file certain disclosure reports otherwise due to be filed between March 1 and July 1, 2020.

- Guidance holding that companies that rely on the timely filing prong to be eligible for use of Form S-3s (including designation as a well-known seasoned issuer) and Form S-8s will still be able to do so as long as they met this prong as of March 1, 2020 and timely file their delayed report within the 45-day extension period. Companies are, however, reminded to file Form 8-K or Form 6-K, as may be required, by the original reporting deadline of the delayed report, and are encouraged to disclose material information related to the impacts of COVID-19 on a timely basis and to avoid selective disclosures and insider transactions prior to disclosure of material information to the public.

- Guidance regarding alternatives to complying with federal proxy rules for upcoming annual meetings in light of health, transportation, and other logistical issues raised by COVID-19. Changes in date, location, or time, as well as "virtual" shareholder meetings (which are governed by state law) are discussed, as well as alternatives for presentation of shareholder proposals by proponents or their representatives in compliance with the Exchange Act.

- An Order under the Investment Company Act of 1940 providing temporary, conditional exemptive relief for regulated business development companies (BDCs) to enable them to make additional investments in small and medium-sized businesses, including those with operations affected by COVID-19. The Order provides additional flexibility for BDCs to issue and sell senior securities in order to provide capital to such companies, and to participate in investments in these companies alongside certain private funds that are affiliated with the BDC.

A full list of the SEC's significant COVID-19-related regulatory relief may be found here.

Delayed Implementation of Revised Control Framework: The Federal Reserve announced on March 31 that it will delay by six months the effective date for its revised control framework, from April 1 to September 30. The delay is intended to reduce the operational burdens placed upon banking organizations so they can focus on assisting customers under the current economic conditions. No substantive changes have been made to the framework itself. For further reading on the Federal Reserve's revised control framework, please see our Client Advisory on the final rule.

Housing: In an effort to mitigate the impact of COVID-19 on the financial well-being of individuals and families, the Federal Housing Administration (FHA) and the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac have implemented a 60-day foreclosure and eviction moratorium for single-family homeowners with FHA-insured mortgages and mortgages backed by these GSEs. Until at least mid-May, servicers of these loans must halt new foreclosure actions and suspend pending foreclosure actions, and must cease evictions of persons from single-family properties with these loans. The Federal Housing Finance Agency has also instructed the GSEs, which it supervises, to provide forbearance relief of up to twelve months for impacted borrowers.

Administrative Agency Deposit Guidance: The FDIC and the SEC have taken the following actions to provide certain relief to banks and broker-dealers in respect of their participation in insured deposit sweep programs:

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- **FDIC Action on Treatment of Sweep Deposits**: Section 29 of the Federal Deposit Insurance Act and the FDIC's implementing regulations impose special rules on so-called "brokered deposits," limiting which insured depository institutions can accept them and in some circumstances imposing higher deposit insurance premiums on banks that hold significant amounts of such deposits. Given the importance of deposits as a source of liquidity, the brokered deposit restrictions can create liquidity constraints for institutions, particularly in times of economic stress. On March 19, 2020, the FDIC published Advisory Opinion 20-21, which, for a period of six months, expands upon existing interpretive guidance generally providing that uninvested funds swept by broker-dealers from their customers transactional accounts into insured deposit accounts with affiliated banks are not viewed as "brokered deposits" if they satisfy certain conditions. Existing FDIC interpretive guidance provides that such affiliated insured sweep deposits are not brokered deposits if the swept funds do not exceed 10% of the total account balance(s) of the customer(s) whose assets are being swept and periodic accounting and reporting requirements are satisfied by the broker-dealer and bank. *See* FDIC Advisory Opinion 05-02. The FDIC's latest guidance increases the allowable volume of uninvested funds that may be swept into insured deposit accounts with affiliated banks to 25% of the total amount of assets handled by the broker-dealer for those clients whose assets are being swept. The accounting, reporting and other administrative conditions set forth under existing FDIC guidance continues to apply during the six-month period in which Advisory Opinion 20-21 will be effective. Increasing this percentage is important because, due to COVID-19-related volatility of the financial markets, investors have redeemed securities investments in favor of cash, requiring broker-dealers to manage much larger uninvested cash balances in their customers' transactional accounts. The FDIC's interpretive guidance will allow broker-dealers to transfer a larger volume of uninvested cash into affiliated insured deposit accounts during the ongoing crisis without such funds being viewed as brokered deposits.

- **SEC Sweep Deposit Interpretation**: Unrelated to the FDIC's brokered deposit guidance, on March 30, 2020, the SEC issued a No-Action Letter granting certain relief to broker-dealers in respect of their compliance with net capital requirements set forth under SEC Rule 15c3-1. The No-Action Letter provides that, in connection with FDIC-insured deposit sweep programs offered to their customers pursuant to SEC Rule 15c3-3, where a broker-dealer pre-funds a customer's transactional account while awaiting the receipt of funds withdrawn from an insured deposit account, the broker-dealer is permitted to treat such funds as a receivable that is an allowable asset not required to be deducted from the broker-dealer's net worth under the SEC's net capital rule for one business day from the creation of the receivable, provided that several conditions are satisfied—including that the customer has no ability to access the insured deposit account without going through the broker-dealer.

STATE-LEVEL ACTIVITY

Many states have instituted relief efforts of their own for individuals who have been impacted by COVID-19. The specifics of these efforts vary, but several broad trends are starting to emerge:

Prohibiting Non-emergency Evictions and Foreclosures. One of the most common state actions is prohibiting non-emergency evictions and foreclosures, especially for residential tenants. This is true for states such as California, Illinois, Massachusetts, New York, and Washington, among others.

Encouraging or Requiring Mortgage Forbearance and Other Accommodations for Financial Customers. Another trend is states encouraging, or even requiring, that financial institutions grant forbearance and other accommodations for borrowers who are experiencing financial hardship as a result of COVID-19. States that have enacted these types of measures include New York, California, and Massachusetts. New York has also ordered its financial institutions to eliminate Automated Teller Machine (ATM) fees, overdraft fees, and late payment fees for impacted borrowers

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

Encouraging or Prohibiting Reporting to Credit Bureaus. In addition to actions taken by the federal government, two states, Massachusetts and New York, are mandating that financial institutions within their jurisdictions refrain from reporting negative credit information to consumer credit bureaus.

Two states have also taken notable actions to curtail efforts by debt collectors. In California, Governor Gavin Newsom signed an executive order that largely prohibits the garnishment of any federal, state, or local aid given to individuals in response to the COVID-19 pandemic and requires the repayment of any money collected in violation of the order—including money collected prior to the order's enactment.[4] And in Massachusetts, the Attorney General's Office issued sweeping emergency restrictions on debt collectors, including those collecting on their own debts, though these restrictions do not apply to debts that are secured by a mortgage on real property or owed by a tenant to an owner.[5]

Interested parties should be sure to refer to each state's official websites regularly for details. State responses do vary, and they may change rapidly based on new information.

ECONOMIC STABILIZATION AND ASSISTANCE TO SEVERELY DISTRESSED SECTORS OF THE UNITED STATES ECONOMY

General Financial Relief Under the CARES Act

Title IV of the CARES Act provides $500 billion to the Treasury Department for loans, loan guarantees, and other investments, including: (1) $25 billion for passenger air carriers and related businesses; (2) $4 billion to cargo air carriers; (3) $17 billion to businesses critical to maintaining national security; and (4) the remaining $454 billion (plus any amounts not used in (1) through (3)) in support of Federal Reserve emergency lending facilities to eligible businesses, states, and municipalities. Requirements for categories (1) and (2) are described in a separate section for air carrier financial relief, and the requirements for category (3) are the same as categories (1) and (2). This section therefore focuses on the different set of requirements that applies to category (4).

The $454 billion in category (4) will be made available through the Federal Reserve's emergency lending authority under section 13(3) of the Federal Reserve Act. Multiple programs and facilities are expected to be established in this category. Eligible businesses are those that did not receive "adequate economic relief" in other parts of CARES Act. The following requirements and conditions apply:

- For direct loans, until one year after the loan is paid off, no stock buybacks unless contractually obligated, and no dividends on common stock;
- For direct loans, restrictions on employee compensation (summarized further below);
- Eligible business must be created or organized in the US or under the laws of the US, and must have significant operations in and majority of employees based in the US;
- No loan forgiveness;
- No conflicts of interest (certification that President, Vice President, executive department head, member of Congress, or their immediate families do not own 20% or more of outstanding equity); and

[4] CA Executive Order N-57-20 (Apr. 23, 2020), .
[5] *See* https://www.mass.gov/doc/ma-reg/download.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

- All the requirements of section 13(3) of the Federal Reserve Act apply, including:
    - Loan collateralization requirement: The relevant statute and regulations provide that all credit extended under 13(3) must be "indorsed or otherwise secured to the satisfaction of the lending Federal Reserve Bank." In practice the Federal Reserve has typically required investment grade collateral even if not statutorily required. It remains to be seen whether Treasury will continue the same practice for the programs and facilities established under the CARES Act.
    - Not being insolvent
        - Certification by the applicant, audited financials, or other information as the Federal Reserve may determine to be relevant.
        - Solvency defined in Federal Reserve regulations as (1) being in bankruptcy, (2) generally not paying undisputed debts as they become due during the 90 days preceding the date of borrowing, or (3) Federal Reserve otherwise determines the applicant is insolvent.

Relief for Mid-Sized Businesses: Within this general $454 billion fund, the CARES Act provides that the Treasury "shall endeavor to implement" a program that provides financing to banks and other lenders that would make direct loans (no higher than 2% interest rate and no payment first six months) to midsize businesses (including nonprofit organizations to the extent practicable) with between 500 and 10,000 employees, subject to additional criteria, including criteria related to workforce retention, workforce restoration, prohibition on outsourcing or offshoring, maintenance of collective bargaining agreements, and remaining neutral in union organizing. These additional criteria do not necessarily apply to other programs and facilities established in this general $454 billion fund.

Employee Compensation Limit: There are two prongs that apply until one year after the loan is paid off:

- For those employees who made over $425,000 in 2019, (1) no pay increase and (2) severance pay capped at twice the total compensation in 2019.
- For those employees who made over $3 million in 2019, total compensation to be capped at $3 million plus 50% of the excess over $3 million (e.g., if total compensation was $4 million in 2019, it will be capped at $3.5 million ($3 million plus 50% of the $1 million in excess of $3 million).

Financial Agents: Treasury is authorized to designate financial institutions—including but not limited to depositories, brokers, dealers, and other institutions—as financial agents of the United States for the purpose of performing the Secretary's duties under Title IV of the CARES Act.

US Gain Provisions: The requirement that the US government will share in any gains made pursuant to such loans would continue to apply for the three-sector specific industries, but not for the broader general business loan pool. Additionally, there is a new provision requiring the Treasury Department to liquidate its interest in any authorized loan programs in Title IV as soon as soon as reasonably practical, while maximizing the US government's interest.

New Inspector General: Section 4018 establishes, within the Treasury Department, the Office of the Special Inspector General for Pandemic Recovery who will oversee implementation of the CARES Act. The President will be responsible for nominating this individual "as soon as practicable after any loan, loan guarantee, or other investment is made" under the program. The Special IG will be subject to the removal provisions in Section 3(b) of Inspector General Act. The Special IG will have authority to conduct, supervise, and coordinate

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

audits and investigations of "the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary," in addition to the Secretary's management of the program. In doing so, the Special IG will have the authorities provided in section 6 of the Inspector General Act of 1978 and will be considered exempt from termination by the Attorney General. The bill authorizes $25 million to fund the Special IG's activities.

Congressional Oversight Commission: The CARES Act creates a Congressional Oversight Commission to oversee the execution of Subtitle A of Title IV of the CARES Act (which includes the emergency relief programs) by the Treasury and the Federal Reserve. The Commission must submit regular reports to Congress and review the implementation of the program. Membership in the Commission will consist of one member appointed by the Speaker of the House, the House Minority Leader, the Senate Majority Leader, and the Senate Minority Leader, respectively. The fifth member, Commission's Chair, will be jointly appointed by the Speaker and the Senate Majority Leader.

AIR CARRIER FINANCIAL RELIEF UNDER THE CARES ACT

Air Carrier Loans and Loan Guarantees

As described above, The Act has allocated up to $29 billion for loans and loan guarantees to air carriers and related businesses. This targeted financing recognizes both the dislocations affecting these businesses and their critical economic and social function. In reviewing the following summary, it is important to keep in mind that, while loans and loan guaranties to air carriers and related businesses are subject to some of the same requirements that apply generally under the Act, there are other specific requirements that need to be followed.

Eligible Businesses: The CARES Act allocates up to $25 billion of its loan facility to make loans and loan guarantees to (1) passenger air carriers; (2) "eligible businesses" that are certified and approved to perform inspections, repair, replace, or overhaul services; and (3) ticket agents. Up to an additional $4 billion is allocated to make loans and loan guarantees to cargo air carriers. The loans and loan guarantees are to be provided only to applicants that are eligible businesses for which credit is not reasonably available at the time of the transaction, and are available only if the obligation of the applicant is "prudently incurred." An "eligible business" includes any air carrier and any United States business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act. The eligible business must have incurred, or be expected to incur, "covered losses" such that the continued operations of the business are jeopardized, as determined by the Treasury Secretary. A "covered loss" is defined as a loss "incurred directly or indirectly as a result of coronavirus, as determined by the Secretary."

Eligible business will need to certify that they were created or are organized in the United States or under the laws of the United States and have significant operations in, and a majority of employees based in, the United States. In addition, each business's principal executive officer and the principal financial officer will need to certify that the proposed borrower is eligible to enter into the transaction, including in particular that it is not a "covered entity," which is an entity "controlled" (by virtue of owning, controlling or holding not less than 20%, by vote or value, of the outstanding amount of any class of equity interests in the entity) by identified "covered individuals," which include the President, the Vice President, the head of any Executive department, any member of Congress, and specified relatives of such persons.

Key Loan Terms: The terms of the loans and loan guarantees are to be determined by the Secretary, but are required to (1) be secured or bear an interest rate that reflects the risk of the loan or loan guarantee 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 coronavirus disease, and (2) be for a term "as short as practicable and in any case not longer than 5 years." No such loan is eligible for loan forgiveness.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

In addition, the Secretary must, as part of the terms of the loan or loan guarantee, receive (a) if the eligible business has issued securities that are traded on a national securities exchange, a warrant or equity interest in the eligible business receiving the loan or the benefit of the loan guarantee, or (b) for other businesses, a warrant or equity interest in the eligible business or a senior debt instrument issued by the eligible business. For eligible businesses in the first category, the Secretary is authorized to take a senior debt instrument upon concluding that the eligible business cannot feasibly issue warrants or equity interests. For the benefit of the American taxpayer, any such warrant or equity interest is to provide an equity appreciation, and any such senior debt instrument is to provide a reasonable interest rate premium. It is indicated that the Secretary would not exercise any voting power with respect to any equity so acquired, but the Secretary is free to sell such interests, and it is unclear whether the intent is that such securities, once sold, could be voting securities.

Additional Conditions: Any business receiving a loan is restricted in its activities for a period through the date 12 months after the loan or loan guarantee is no longer outstanding. During that period, the business (1) may not pay dividends or make other capital distributions with respect to its common stock, and (2) may not (directly or through an affiliate) purchase any of its equity securities (or equity securities of a parent) that are listed on a national securities exchange, unless pursuant to a contract in place before adoption of the CARES Act.

In addition, the borrower must, through September 30, 2020, maintain its employment levels at the same levels that existed as of March 24, 2020, to the extent practicable, and in any case shall not reduce its employment levels by more than 10% from the levels as of such date.

Further, from the date the loan agreement is executed through the date one year after the date on which the loan or loan guarantee is no longer outstanding, executive compensation is restricted as follows: (i) Except as otherwise mandated pursuant to a collective bargaining agreement entered into prior to March 1, 2020, no officer or employee receiving "total compensation" (including salary, bonuses, awards of stock and other financial benefits) in excess of $425,000 in 2019 may receive compensation in excess of such amount received in 2019 during any 12-month period while such restrictions are in place, or receive severance payments in excess of twice that amount; and (ii) no officer or employee whose total compensation exceeded $3,000,000 in 2019 may receive, during any such 12-month period, compensation in excess of $3,000,000 plus 50% of the excess over $3,000,000 received in 2019. The Secretary of Transportation is authorized, through March 1, 2022, to require any air carrier receiving a loan or the benefit of a loan guarantee to maintain scheduled air transportation service as the Secretary of Transportation deems necessary to ensure services to any point serviced by such air carrier prior to March 1, 2020. A similar requirement regarding the maintenance of air transportation service applies to air to air carriers receiving the support grants described under "Air Carrier Worker Support" below. On April 7, 2020, the Department of Transportation issued an order prescribing the minimum flight requirements that will apply through September 30, 2020.

Applicable Procedures: Preliminary procedures and requirements for loans for air carriers were announced on March 30, 2020, with a statement that such procedures and requirements will be supplemented with additional procedures and a loan application form, and such procedures may be modified at any time. The requirements identified in the announcement merely set out those already included in the statute as described above, but the announcement provided a preview of information that would be required to obtain a loan. Loan guarantees were not addressed.

As part of the loan application process, a prospective borrower will be required to provide information regarding (1) the borrower's existing secured and unsecured debt, its bank and other credit lines with outstanding maximum balances, and the major classes of existing security holders and creditors; (2) the borrower's scheduled debt service for the next three months; (3) the borrower's employment levels, by head count and total compensation, as of March 24, 2020, and proposed changes thereto during 2020; (4) the borrower's consolidated financial statements for the previous 3 years; (5) the covered losses incurred or expected to be incurred by the borrower; (6) evidence that the borrower cannot obtain credit elsewhere; (7) for passenger air

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

carriers, the available seat miles, revenue per seat mile, and cost per available seat in 2019, and for cargo air carriers, available ton miles, revenue per ton mile, and cost per available ton mile for 2019, and in each case a forecast of the same for 2020; (8) a description of security available to be pledged for the loan, (9) the proposed use of proceeds; (10) quantitative information on the borrower's financial needs for the remainder of 2020; (11) an operating plan for the remainder of 2020; and (12) a description of any plans for restructuring the borrower's obligations, contracts, staffing, or organization to improve its financial condition. The borrower is also expected to present a description of the warrants or equity interests, or the senior debt obligations, it proposes to issue to the Treasury Department.

The Treasury Department is expected to coordinate with the Department of Transportation, and Treasury may reveal any information it receives to the Department of Transportation.

Air Carrier Worker Support

In addition to the loan and loan guarantee provided to air carriers in Subtitle A of Title IV of the CARES Act, Subtitle B of Title IV provides financial assistance in the form of support grants for the exclusive use of employee wages, salaries, and benefits up to the following amounts: (1) $25 billion for passenger air carriers, (2) $4 billion for cargo air carriers, and (3) $3 billion for airline contractors (defined as airport ground support or catering services for the air carrier industry).

The awardable amount equals salaries and benefits reported pursuant to 14 CFR Part 241 for the period from April 1, 2019, through September 30, 2019, and for those who do not report pursuant to 14 CFR Part 241, self-certified amount of wages, salaries, benefits, and other compensation for the same time period. Approved applicants may receive payroll support in multiple payments, with the amounts and timing of such payments to be at Treasury's discretion.
Treasury has published guidelines and application procedures, with applications due April 3, 2020 (applications submitted after that date will be considered but may not be approved as quickly).

To be eligible to receive payments, an applicant must agree to:

- use such payments exclusively for the continuation of employee wages;
- refrain from conducting involuntary layoffs or furloughs, or reducing pay rates and benefits, of employees of the applicant and its subsidiaries until September 30, 2020;
- through September 30, 2021, ensure that neither the applicant nor any subsidiary or affiliate purchases, in any transaction, an equity security of the applicant or the direct or indirect parent company of the applicant that is listed on a national securities exchange; and
- through September 30, 2021, ensure that the applicant does not pay dividends, or make other capital distributions, with respect to common stock (or equivalent interest) of the applicant or any subsidiary thereof.

A number of other conditions apply, including those relating to protecting collective bargaining agreements, limiting employee compensation, and protecting taxpayers by authorizing Treasury to receive financial compensation in the form of warrants, options, preferred stock, debt securities, notes, or other financial instruments issued by recipients of payroll support. On April 10, 2020, the Treasury Secretary announced that Treasury will not require such financial compensation from air carriers receiving $100 million or less in payroll support. However, for those receiving above $100 million, the Treasury would offer 70% in aid as grants that would not need to be repaid, and 30% in low-interest loans for which the air carriers would have to offer warrants. The warrants would give the government the right to buy equity at a pre-set price and time, and would be equal to 10% of the value of the loan.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.

To be eligible for payroll support, an applicant must complete the Payroll Support Application Form and submit a proposal identifying a financial instrument and proposed terms that would provide appropriate compensation to the government in exchange for payroll support. An applicant must also complete a Payroll Support Agreement, which will be provided by the Treasury Department after an application is received. The Payroll Support Agreement will include terms addressing:

- assurances described above;
- employee compensation limits;
- certain other conditions and covenants: and
- clawback of payments upon the applicant's failure to satisfy its assurances, conditions, or agreements.

With respect to companies seeking access to the $17 billion allocated to companies that are deemed critical to national security under the CARES Act, the Secretary of the Treasury is requiring as part of the loan application that in order to get a loan, borrowers provide the Treasury Department with appropriate financial instruments that in the Secretary's sole determination, provide for a reasonable participation in equity appreciation or a reasonable interest rate premium appropriate for the benefit of taxpayers. In this regard, borrowers that are publicly traded companies will be required to provide warrants or other equity interest unless the Secretary determines that the Borrower cannot feasibly do so. For other borrowers, the Secretary may in its discretion accept senior debt instruments or warrants or other equity interests.

* * * * *

The CARES Act provisions and administrative actions described in this Advisory represent massive efforts to address the economic crisis facing the United States. They create both opportunities and risks for businesses, individuals, and state and local governments. How they will ultimately play out remains to be seen, particularly given that the rulemakings and other guidance necessary to implement them has only begun. The situation is constantly changing, leading to subsequent updates to regulatory actions and programs and policies described in this Advisory. Anyone interested in the outcome of this process would be well advised to pay close attention.

© Arnold & Porter Kaye Scholer LLP 2020 All Rights Reserved.