Proskauer

The Booster Shot—Federal Reserve Liquidity Programs for Eligible Businesses under Title IV of the CARES Act

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On March 27, 2020, Congress passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), which provides approximately $2.2 trillion in relief programs to U.S. individuals, businesses, states and municipalities. Title IV of the CARES Act provides for up to $500 billion in loans and loan guarantees to, and other investments in, Federal Reserve programs and facilities, to be made available to U.S. businesses that have not otherwise received adequate economic relief in the form of loans and loan guarantees under the CARES Act. The programs available under Title IV will be entirely new and are separate from the federally-guaranteed loans offered by the Small Business Administration under Title I of the CARES Act. (For more information about the Title I loan programs, see here.) Detailed rules and regulations are expected to be announced in the coming days and weeks.

The $500 billion in Title IV relief is comprised of up to:

- $25 billion for air carriers and certain related businesses
- $4 billion for cargo air carriers
- $17 billion for businesses critical to maintaining national security, and
- $454 billion (plus any remainder of the $46 billion for air carriers and national security) to provide liquidity to other eligible U.S. businesses, states and municipalities related to losses incurred as a result of coronavirus.

This client alert focuses on the $454 billion plus in loan, guarantee and investment programs under Title IV, Section 4003(b)(4) of the CARES Act (the "4003(b)(4) Programs"). The form of the 4003(b)(4) Programs has yet to be determined, and the Federal Reserve and the Treasury have discretion to implement a variety of liquidity measures. This may include buying back corporate or municipal bonds or loans, guaranteeing or otherwise backstopping municipal or corporate debt, making direct loans to U.S. businesses, or other eligible forms of investment. Whatever measures are ultimately deployed, the Federal Reserve is expected to leverage funding from the U.S. Treasury to implement the 4003(b)(4) Programs, which would result in liquidity well in excess of the nominal $454 billion allocated under the CARES Act. The 4003(b)(4) Programs thus will be designed to give the U.S. economy what has been referred to as a multi-trillion dollar "booster shot."

As described in the CARES Act, the 4003(b)(4) Programs will be implemented through the Federal Reserve by purchasing obligations or other interests directly from issuers, purchasing obligations or other interests in secondary markets, and making loans directly to borrowers, including in the form of loans or other advances secured by collateral. The 4003(b)(4) Programs will be in a form and subject to other terms and conditions, including covenants, representations and warranties, and other requirements (including audit requirements), as determined by the U.S. Treasury.

Although more detailed rules and regulations are expected to follow, the CARES Act provides certain terms and conditions of the 4003(b)(4) Programs, including:

- 4003(b)(4) Programs will have interest rates determined by the U.S. Treasury based on the applicable risk and comparable market rates.
- The maturity date will be no longer than five years.
- 4003(b)(4) Programs will not be eligible for loan forgiveness.
- 4003(b)(4) Programs will be subject to applicable requirements under the Federal Reserve Act, including loan collateralization, taxpayer protection and borrower solvency.
- Borrower will be prohibited from engaging in stock buybacks of nationally listed shares, unless contractually obligated prior to enactment of the CARES Act, or from paying dividends or making other capital distributions with respect to common stock, until one year after the loan is no longer outstanding.

- Borrower will be also prohibited from increasing the compensation of any employee whose compensation exceeds $425,000 or from offering them significant severance or termination benefits until one year after the termination of the applicable loan or loan guaranty.
- Borrower's officers and employees whose total compensation exceeded $3 million in 2019 cannot receive compensation greater than $3 million, plus 50% of the amount over $3 million that the individual received in 2019. It is unclear how these compensation provisions will apply to newly hired employees who had no 2019 compensation from the applicable borrower.

The CARES Act provides that the conditions of the 4003(b)(4) Programs related to share repurchases, distributions and employee compensation may be waived by the Treasury Secretary if he determines that a waiver is "necessary to protect the interests of the Federal Government" and makes himself available to testify before the Senate's Committee on Banking, Housing, and Urban Affairs regarding such waiver.

In addition, the CARES Act directs the Treasury Secretary to implement a 4003(b)(4) Program to provide financing to banks and other lenders to make direct loans to eligible medium-sized businesses, including nonprofit organizations (the "Mid-Sized Business Program"). Requirements and restrictions applicable to a borrowers under the Mid-Sized Business Program include:

- Borrower must have between 500 and 10,000 employees. The CARES Act does not introduce any affiliation rules with respect to the employee size test, but this is not necessarily determinative given the program has yet to be established.
- Borrower must be a United States business with significant operations in, and a majority of employees based in, the United States.
- Borrower has not otherwise received adequate economic relief in the form of loans or guarantees provided by the CARES Act.
- The uncertainty of economic conditions makes the loan request necessary for ongoing operations.
- Annualized interest rate is capped at 2% per annum.
- No principal or interest payments required for the first six months.
- Funds will be used to retain 90% of workforce at full compensation and benefits through September 30, 2020.

- Borrower intends to restore 90% of workforce that existed as of February 1, 2020, and restore all compensation and benefits no later than 4 months after termination date of public health emergency (as declared by the Secretary of Health and Human Services).
- Borrower is not a debtor in an insolvency proceeding.
- Borrower will not pay dividends on common stock or repurchase equity securities listed on a national securities exchange of borrower or any parent company while the loan is outstanding, unless contractually obligated prior to enactment of the CARES Act.
- Borrower will not outsource or offshore jobs for the term of the loan and for two years after repayment.
- Borrower will not abrogate existing collective bargaining agreements for the term of the loan and for two years after repayment, and will remain neutral in any union organizing effort for the term of the loan.

Separately, the CARES Act includes a placeholder for an additional "Main Street Lending Program" to support lending to small and mid-sized U.S. businesses.

Any loans made or guaranteed under a 4003(b)(4) Program would be treated for tax purposes as debt issued at par, and stated interest on these loans would be treated as qualified stated interest. As a result, loans issued or guaranteed under the program would not be treated as issued with original issue discount for tax purposes, and cash basis taxpayers would not be permitted to deduct interest on the loans until that interest is paid. For more information about the tax implications of the CARES Act, see Coronavirus: The Senate Passes the CARES Act; Summary of the Tax Provisions of the Bill .

Procedures and other requirements for 4003(b)(4) Programs are expected to be announced by the U.S. Treasury soon. We will continue to monitor the additional rules and regulations as they become available.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

Related Professionals

- **Jeffrey A. Horwitz**
  Partner
- **Susan R. Goldfarb**
  Special Finance Counsel
- **David S. Miller**
  Partner
- **Yuval Tal**
  Partner
- **Grant R. Darwin**
  Partner