

CORONAVIRUS: THE ECONOMIC STABILIZATION PROVISIONS OF THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “**CARES Act**”) was [enacted](#) by the US Congress and signed into law. The CARES Act is by far the largest economic and emergency aid package in US history, authorizing roughly \$2 trillion in expenditures by the Federal government. More than simply providing economic stimulus, the legislation is a vehicle for an array of direct relief measures for individuals, businesses, cities and states, all of which have come under extreme pressure as a result of the COVID-19 pandemic. We expect that further Federal legislative and administrative actions, in addition to those taken or contemplated by the CARES Act, will ultimately be required to restore growth to the beleaguered US economy.

This briefing covers the economic stabilization provisions of the CARES Act, specifically the Coronavirus Economic Stabilization Act of 2020 (“**CESA**”), enacted as Title IV, Subtitle A of the CARES Act. CESA authorizes the Secretary of the US Treasury to make—

- up to \$25 billion of loans and loan guarantees to US passenger air carriers, up to \$4 billion of loans and loan guarantees to US cargo air carriers, and up to \$17 billion of loans and loan guarantees to US businesses critical to maintaining national security (“**Air Carrier & National Security Assistance**”), and
- up to \$454 billion (plus the amount of any unused Air Carrier & National Security Assistance) of loans and loan guarantees to, and other investments in, Federal Reserve programs or facilities that support lending to eligible businesses, states and municipalities (“**Federal Reserve Program Assistance**”).

The Secretary is to determine the terms and conditions of each loan, loan guarantee and other investment made pursuant to the Air Carrier & National Security

Assistance and Federal Reserve Program Assistance authorities under CESA, subject to the requirements described below. Loans are to be made at a rate “determined by the Secretary based on the risk and the current average yield on [Treasury securities] of comparable maturity.” CESA prohibits loan forgiveness that reduces the principal amount of any Air Carrier & National Security Assistance or Federal Reserve Program Assistance obligation issued by an eligible business, state or municipality.

Air Carrier & National Security Assistance

Basic terms and eligibility requirements

CESA requires the Treasury Secretary to publish application procedures and minimum requirements for Air Carrier & National Security Assistance loans and loan guarantees within 10 days of enactment of the CARES Act (*i.e.*, by April 6, 2020). The Secretary may enter into an agreement to make an Air Carrier & National Security Assistance loan or loan guarantee (an “**Air Carrier & National Security Loan Agreement**”) if:

- the Secretary determines that (i) the applicant is an eligible business for which credit is not “reasonably available” at the time of the transaction, (ii) the eligible business has incurred or is expected to incur covered losses such that “the continued operations of the business are jeopardized” and (iii) the obligation would be “prudently incurred” by the eligible business;
- the loan or loan guarantee is sufficiently secured **or** is made at a rate that (i) reflects the risk of the loan or loan guarantee and (ii) to the extent practicable, is not less than the prevailing rate for comparable obligations prior to the coronavirus outbreak; and
- the duration of the loan or loan guarantee is as short as practicable and in any case not longer than five years.

Eligible business is defined as a US citizen air carrier or other US business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act.

Covered losses are defined to include losses incurred directly or indirectly as a result of coronavirus.

Any Air Carrier & National Security Loan Agreement must include a certification by the eligible business that it is organized in the United States or under the US law and has significant operations in and a majority of its employees based in the United States.

Conditions of assistance

CESA requires Air Carrier & National Security Loan Agreements to contain certain provisions that significantly constrain the discretion of an eligible business’s management.

- *Repurchases, dividends and distributions*

An Air Carrier & National Security Loan Agreement must provide that, during the term of the loan or loan guarantee and until the first anniversary of the date on which it is no longer outstanding,

- neither the eligible business nor any of its affiliates may repurchase a listed equity security of the eligible business or its

parent company (if any), except to the extent required under a contractual obligation in effect as of March 27, 2020, and

- the eligible business may not pay dividends or make other capital distributions with respect to its common stock.

- *Employment levels*

An Air Carrier & National Security Loan Agreement must provide that, until September 30, 2020, the eligible business shall maintain its employment levels existing as of March 24, 2020, to the extent practicable, and in any case shall not reduce its employment levels by more than 10% from its employment levels existing as of March 24, 2020.

- *Limitations on officer and employee compensation*

An Air Carrier & National Security Loan Agreement must provide that, during the term of the loan or loan guarantee and until the first anniversary of the date on which it is no longer outstanding (the “**Limitation Period**”),

- no officer or employee of the eligible business whose total compensation exceeded \$425,000 in calendar year 2019 (other than an employee whose compensation was determined pursuant to collective bargaining agreement entered into prior to March 1, 2020) may receive (i) total compensation which exceeds, during any 12 consecutive months of the Limitation Period, the total compensation received by the officer or employee from the eligible business in calendar year 2019 or (ii) severance pay or other benefits upon termination of employment which exceeds twice the maximum total compensation received by the officer or employee from the eligible business in calendar year 2019; and
- no officer or employee of the eligible business whose total compensation exceeded \$3,000,000 in calendar year 2019 may receive, during any 12 consecutive months of the Limitation Period, total compensation which exceeds the sum of (i) \$3,000,000 and (ii) 50% of the total compensation in excess of \$3,000,000 received by the officer or employee from the eligible business in calendar year 2019.

The foregoing limitations on officer and employee compensation are referred to as the “**CESA Compensation Limits**” herein.

Total compensation is defined to include salary, bonuses, awards of stock, and other financial benefits provided by an eligible business to an officer or employee of the eligible business. CESA does not prescribe how equity awards and other financial benefits should be valued for purposes of calculating total compensation.

Upside protections for the Treasury

CESA requires that Air Carrier & National Security Assistance loans and loan guarantees be structured to provide the Treasury with a participation in equity appreciation or an interest rate premium, depending on the circumstances.

- If the eligible business is a US publicly traded company, the Treasury must receive a warrant or other equity interest in the eligible business, unless the Secretary determines that the eligible business cannot feasibly issue

warrants or other equity interests, in which case the Treasury may accept a senior debt instrument issued by the eligible business.

- If the eligible business is not a US publicly traded company, the Treasury must receive, in the Secretary's discretion, either a warrant or other equity interest in the eligible business or a senior debt instrument issued by the eligible business.
- The terms and conditions of any warrant, other equity interest or senior debt instrument issued by the eligible business must be "designed to provide for a reasonable participation by the Secretary, for the benefit of taxpayers, in equity appreciation in the case of a warrant or other equity interest, or a reasonable interest rate premium, in the case of a debt instrument."

The Secretary is authorized to sell, exercise or surrender any warrant but prohibited from exercising voting rights with respect to any shares of common stock acquired from an eligible business in connection with an Air Carrier & National Security Assistance loan or loan guarantee.

Air service requirements

CESA grants the Secretary of Transportation the authority to require any air carrier that receives Air Carrier & National Security Assistance loans and loan guarantees to maintain, "to the extent reasonable and practicable," scheduled air transportation service as the Transportation Secretary determines is necessary to ensure services to any point served by such air carrier before March 1, 2020 ("**Continuation Requirements**"). In making the determination whether to impose Continuation Requirements, the Transportation Secretary is obliged to take into consideration "the air transportation needs of small and remote communities and the need to maintain well-functioning health care and pharmaceutical supply chains, including for medical devices and supplies." The Transportation Secretary's authority to impose Continuation Requirements, including any Continuation Requirement then outstanding, terminates on March 1, 2022.

Aviation excise taxes

In addition to Air Carrier & National Security Assistance, CESA includes a tax holiday, lasting until January 1, 2021, from (i) the 7.5% aviation excise tax on the transportation of passengers, (ii) the 6.25% aviation excise tax on the transportation of cargo and (iii) certain excise taxes on kerosene used in commercial aviation.

Federal Reserve Program Assistance

Federal Reserve Program Assistance loans, loan guarantees and other investments with respect Federal Reserve programs or facilities are likely to be made from Treasury's Exchange Stabilization Fund (the "**ESF**") and provided to a special purpose vehicle established by the Federal Reserve or otherwise. The Treasury has already used the ESF to provide a total of \$50 billion of equity investments and credit protection to the six Federal Reserve facilities previously established to address the economic consequences of the COVID-19 pandemic: the Commercial Paper Funding Facility (the "**CPFF**"), the Primary Dealer Credit Facility (the "**PDCF**"), the Money Market Mutual Fund Liquidity Facility (the "**MMLF**"), the Term

Asset-Backed Securities Loan Facility (“**TALF**”), the Primary Market Corporate Credit Facility (the “**PMCCF**”) and the Secondary Market Corporate Credit Facility (the “**SMCCF**”) and, together with the CPFF, the PDCF, the MMLF, TALF and the PMCCF, the “**Pre-CESA Facilities**”). In addition to the ESF’s contribution of \$454 billion (plus the amount of any unused Air Carrier & National Security Assistance), we expect that the Federal Reserve will use leverage to increase the capacity of the special purpose vehicles and other structures that receive Federal Reserve Program Assistance.

Basic terms and eligibility requirements

Federal Reserve Program Assistance is generally available for Federal Reserve programs or facilities that support lending to eligible businesses, states and municipalities by (i) purchasing obligations or other interests directly from issuers, (ii) purchasing obligations or other interests in secondary markets, and (iii) making loans and other advances secured by collateral.

CESA stipulates, however, that such Federal Reserve programs or facilities may only purchase obligations or other interests (other than “securities that are based on an index or that are based on a diversified pool of securities”) issued by, or make loans or other advances to, an eligible business that is organized in the United States or under US law and that has significant operations in and a majority of its employees based in the United States.

Federal Reserve Act requirements

“For the avoidance of doubt,” CESA makes clear that the requirements of Section 13(3) of the Federal Reserve Act are applicable to any program or facility that receives Federal Reserve Program Assistance. Section 13(3), among other things, requires the program or facility—

- to have “broad-based eligibility,” meaning that the program or facility is designed “for the purpose of providing liquidity to the financial system” and not “structured to remove assets from the balance sheet of a single and specific company” or to help the company avoid insolvency;
- to prohibit borrowing by insolvent entities or businesses; and
- to require all loans to be satisfactorily secured by specific collateral.

Section 13(3) applies to each of the Pre-CESA Facilities as well as to the Federal Reserve’s forthcoming Main Street Business Lending Program.

Requirements for direct lending programs

CESA imposes certain additional requirements on Federal Reserve Program Assistance with respect to Federal Reserve programs and facilities that make direct loans.

The Treasury Secretary may make a Federal Reserve Program Assistance loan, loan guarantee or other investment with respect to a direct loan program or facility only if each eligible business agrees (under a “**Federal Reserve Program Direct Loan Agreement**”) to certain provisions that significantly constrain the discretion of the eligible business’s management.

A **direct loan** is defined as a loan under a bilateral loan agreement entered into directly with an eligible business as borrower; the definition specifically excludes syndicated loans, loans originated by financial institutions in the ordinary course of business, and securities or capital markets transactions.

Under this definition, the PMCCF is the only one of the six Pre-CESA Facilities that is designed to make direct loans.

- *Repurchases, dividends and distributions*

A Federal Reserve Program Direct Loan Agreement must provide that, during the term of the direct loan until the first anniversary of the date on which it is no longer outstanding,

- the eligible business may not repurchase a listed equity security of the eligible business or its parent company (if any), except to the extent required under a contractual obligation in effect as of March 27, 2020, and
- the eligible business may not pay dividends or make other capital distributions with respect to its common stock.

- *Limitations on officer and employee compensation*

A Federal Reserve Program Direct Loan Agreement must provide that the eligible business will comply with the same CESA Compensation Limits as are applicable to the eligible business under an Air Carrier & National Security Loan Agreement.

- *Waivers*

CESA permits the Treasury Secretary to waive the foregoing requirements for Federal Reserve Program Direct Loan Agreements with respect to any direct loan program or facility upon a determination that such waiver is necessary to protect the interests of the Federal Government. In such a case, however, the Secretary must be available to testify before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives regarding the reasons for the waiver.

Assistance for mid-sized businesses

CESA requires the Treasury Secretary to seek the implementation of a Federal Reserve program or facility ("**Mid-Sized Business Credit Facility**") that provides financing to banks and other lenders to make direct loans to eligible businesses, including nonprofit organizations "to the extent practicable," with between 500 and 10,000 employees. A direct loan made by any Mid-Sized Business Credit Facility would bear an annualized interest rate capped at 2% and would provide that no principal and interest payments are due for the first six months after the loan is made. An applicant for a direct loan from any Mid-Sized Business Credit Facility would make a good-faith certification as to various matters, including that—

- the proceeds of the loan will be used to retain at least 90% of its workforce, at full compensation and benefits, until September 30, 2020;
- the applicant intends to restore not less than 90% of its workforce in existence as of February 1, 2020, and to restore all compensation and benefits, no later than four months after the termination of the COVID-19 public health emergency;
- the applicant is organized in the United States or under US law and has significant operations in and a majority of its employees based in the United States;

- the applicant is not a debtor in a bankruptcy proceeding;
- while the direct loan is outstanding, the applicant will not pay dividends with respect to the common stock of the business or repurchase a listed equity security of the business or its parent company (if any), except to the extent required under a contractual obligation in effect as of March 27, 2020;
- for the term of the direct loan and for two years following repayment, the applicant (i) will not outsource or offshore jobs and (ii) will not abrogate existing collective bargaining agreements; and
- for the term of the direct loan, the applicant will remain neutral in any union organizing effort.

CESA expressly provides that the implementation of a Mid-Sized Business Credit Facility does not limit the Federal Reserve programs and facilities otherwise eligible for Federal Reserve Program Assistance loans, loan guarantees and other investments, nor does it limit the Federal Reserve's discretion to establish the forthcoming Main Street Business Lending Program in addition to any Mid-Sized Business Credit Facility.

Tax treatment of Treasury loans and loan guarantees

CESA provides that loans made or guaranteed pursuant to the Air Carrier & National Security Assistance and Federal Reserve Program Assistance authorities will be treated as debt for US Federal income tax purposes. Any such loan will be treated as issued for its stated principal amount, and stated interest on the loan will be treated as "qualified stated interest" under the Federal tax code.

CESA requires the Treasury to prescribe regulations or guidance providing that the acquisition of warrants, stock options, common or preferred stock or other equity from an eligible business in connection with an Air Carrier & National Security Assistance loan or loan guarantee will not result in an "ownership change" for purposes of Section 382 of the Federal tax code. An ownership change could otherwise limit the eligible business's ability to carry forward its net operating losses to future years.

Certain temporary and other relief measures

Emergency financial stabilization under the Dodd-Frank Act

Under the Dodd-Frank Act, and upon a determination by the Federal Reserve and the FDIC that a "liquidity event" exists, the FDIC is authorized to establish a guarantee program for the obligations of solvent insured depository institutions and depository institution holding companies during times of severe economic distress ("**Debt Guarantee Program**"). CESA amends the congressional joint resolution provisions of the Dodd-Frank Act to give advance approval for the creation of a Debt Guarantee Program upon a liquidity event determination by the Federal Reserve and the FDIC, provided that the Debt Guarantee Program and any guarantees issued thereunder terminate no later than December 31, 2020.

CESA also amends the Dodd-Frank Act to expand the FDIC's guarantee power to include deposits held by solvent insured depository institutions in noninterest-

bearing transaction accounts, effectively providing unlimited Federal deposit insurance of such deposits for the first time since 2012.

Exemptions from national bank lending limits

CESA amends the lending limit provisions of the National Bank Act to—

- provide a temporary exemption from lending limits for loans or extensions of credit to any “nonbank financial company” (as defined in the Dodd-Frank Act) with the approval of the Office of the Comptroller of the Currency; and
- give the OCC temporary authority to exempt any transaction from lending limits upon a finding that the exemption is in the public interest and consistent with the purposes of the National Bank Act’s lending limit provisions.

The amendments to the National Bank Act’s lending limit provisions expire on the earlier of (i) the termination date of the COVID-19 national emergency and (ii) December 31, 2020.

Troubled debt restructurings

CESA permits financial institutions temporarily to suspend US GAAP requirements for loan modifications related to the COVID-19 pandemic that would otherwise be characterized as troubled debt restructurings, including “impairment for accounting purposes” determinations with respect to loans modified as a result of the COVID-19 pandemic. The Federal banking agencies are required to defer to a financial institution’s election to suspend such requirements.

A financial institution may suspend US GAAP requirements with respect to pandemic-related loan modifications only for the period beginning on March 1, 2020 and ending on the earlier of (i) the termination date of the COVID-19 national emergency and (ii) December 31, 2020.

Current expected credit losses (CECL)

CESA provides that insured depository institutions, bank holding companies and their affiliates are not required to comply with Financial Accounting Standards Board Accounting Standards Update No. 2016-13 (“Measurement of Credit Losses on Financial Instruments”), including the current expected credit losses (CECL) methodology for estimating allowances for credit losses, during the period ending on the earlier of (i) the termination date of the COVID-19 national emergency and (ii) December 31, 2020.

On March 27, 2020, the same day the CARES Act was enacted, the Federal banking agencies issued an [interim final rule](#) that allows banking organizations to mitigate the effects of the CECL methodology in calculating their regulatory capital. Banking organizations that adopt CECL in 2020 may delay the estimated cumulative regulatory capital effects for up to two years, followed by a three-year transition period to phase out the aggregate amount of the regulatory capital benefit provided during the initial two-year delay.

Guarantee of money market mutual funds

The Emergency Economic Stabilization Act of 2008 prohibits the Treasury from using the ESF to establish guarantee programs for the money market mutual fund

(“**MMMF**”) industry. CESA lifts the prohibition on MMMF guarantees during the period ending December 31, 2020. Any guarantee must (i) be limited to the total value of each shareholder’s account in a participating MMMF as of the close of business on the day before the announcement of such guarantee and (ii) terminate not later than December 31, 2020.

Oversight and ethics

Special Inspector General for Pandemic Recovery

CESA provides for a Special Inspector General for Pandemic Recovery (the “**SIGPR**”) to be appointed by the President and confirmed by the Senate as soon as practicable after the first loan, loan guarantee and other investment is made pursuant to the Air Carrier & National Security Assistance and Federal Reserve Program Assistance authorities. The SIGPR may be removed from office by the President in accordance with the Inspector General Act of 1978, which requires the President to communicate in writing the reasons for such removal to the House and Senate within 30 days.

The SIGPR is charged with the duty to “conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments” made by the Treasury pursuant to CESA. In addition to subpoena and police powers under the Inspector General Act, the SIGPR is given broad authority to request information and assistance from other Federal government agencies and entities. CESA requires the SIGPR to report to Congress on a quarterly basis, beginning no later than 60 days after the SIGPR’s Senate confirmation.

The President’s March 27, 2020 [statement](#) upon signing the CARES Act into law noted the requirement that the SIGPR must report to Congress “without delay” any refusal or failure to provide requested information or assistance that, in the SIGPR’s judgement, is unreasonable, and said “I do not understand, and my Administration will not treat, this provision as permitting the SIGPR to issue reports to the Congress without the presidential supervision required by the Take Care Clause, Article II, section 3.”

Congressional Oversight Commission

CESA establishes a Congressional Oversight Commission, within the legislative branch, to conduct oversight of the implementation by the Treasury and the Federal Reserve of the Air Carrier & National Security Assistance and Federal Reserve Program Assistance authorities under CESA and the efforts of the Treasury and the Federal Reserve to provide economic stability as a result of the COVID-19 pandemic. The Oversight Commission has five members: a chairperson jointly appointed by the House Speaker and the Senate Majority Leader and four other members appointed by the House Speaker, the House Minority Leader, the Senate Majority Leader and the Senate Minority Leader, respectively.

The Oversight Commission is required to report to Congress every 30 days, beginning no later than 30 days after any loan, loan guarantee and other investment is made pursuant to the Air Carrier & National Security Assistance and Federal Reserve Program Assistance authorities. The Oversight Commission has the authority to hold hearings, take testimony and receive evidence, as well as to secure

directly from any Federal government department or agency information necessary to perform its functions.

Conflicts of interest

No entity in which the President, the Vice President, the head of Cabinet department, or a member of the House or Senate (or the spouse, child, son-in-law, or daughter-in-law of any of them) directly or indirectly holds a controlling interest is eligible for “any transaction” under CESA’s Air Carrier & National Security Assistance and Federal Reserve Program Assistance authorities. A “controlling interest” is defined as ownership or control of at least 20%, by vote or value, of any class of such entity’s equity interests. Any entity seeking to enter into a transaction under CESA must certify to the Treasury and the Federal Reserve that such entity is not disabled by the foregoing prohibition.

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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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