Cravath, Swaine & Moore LLP

# COVID-19: Certain Financing Provisions of the CARES Act & Federal Reserve Facilities

AUGUST 11, 2020

**The following summary of federal law is based on the version of the CARES Act signed by the President on March 27, 2020 and other federal actions taken as of that date**

**Subject to change with further developments**

# Federal Reserve Lending Program (Overview)

- **The CARES Act authorized $454 billion in loans and loan guarantees to, and other investments in, programs or facilities established by the Federal Reserve to:**
  - Purchase obligations or other interests directly from issuers or in secondary markets; and
  - Make loans, including secured loans or other advances
- **The form, terms and conditions of any loan, loan guarantee or other investment will be determined by the Secretary of the Treasury (the "Secretary")**
  - Interest rates shall be determined based on the risk and the current average yield on outstanding marketable obligations of the U.S. of comparable maturity
- **Loans, loan guarantees and other investments are only available to businesses created or organized in the U.S. (or under the laws of the U.S.) and that have significant operations in, and a majority of employees based in, the U.S.**
- **Any applicable requirements under Section 13(3) of the Federal Reserve Act (including requirements relating to loan collateralization, taxpayer protection and borrower solvency) will apply with respect to any program or facility**
- **The principal amount of any obligation issued under such programs are not contemplated to be eligible for loan forgiveness**

# Federal Reserve Lending Program (Restrictions)

- **To be eligible to receive a loan, loan guarantee or other investment under a program that provides direct loans, an eligible business must agree to the following restrictions on stock buybacks, payment of dividends and executive compensation (in each case, until the date that is 12 months after the loan is repaid):**
  - Not to repurchase a publicly listed equity security of the eligible business or any parent company (except for contractual obligations in effect as of the date of the CARES Act);
  - Not to pay dividends or make other capital distributions with respect to its common stock; and
  - Not to exceed the following compensation limits:
    - No officer or employee whose total compensation exceeded $425,000 in CY 2019 (other than as determined through a collective bargaining agreement entered into prior to March 1, 2020):
      - Will receive total compensation exceeding, during any 12 consecutive months, the total compensation received in CY 2019; or
      - Will receive severance pay or benefits which exceed twice the total compensation received in CY 2019
    - No officer or employee whose total compensation exceeded $3,000,000 in CY 2019 may receive, during any 12 consecutive months, total compensation in excess of the sum of:
      - $3,000,000; and
      - 50% of the excess over $3,000,000 of the total compensation received in CY 2019
    - "Total compensation" includes salary, bonuses, awards of stock, and other financial benefits

- **A "direct loan" means a loan under a bilateral loan agreement that is:**
  - Entered into directly with an eligible business as borrower; and
  - Not part of a syndicated loan, a loan originated by a financial institution in the ordinary course of business, or a securities or capital markets transaction

- **The Secretary may waive the above restrictions upon a determination that such waiver is necessary to protect the interests of the federal government**
  - The Secretary must then be available to testify in front of congressional committees to explain the waiver

# Federal Reserve Main Street Lending Program (Overview)

- **The Federal Reserve created a Main Street Lending Program that will indirectly offer loans to small and medium-sized businesses, comprised of three facilities**
  - The Main Street New Loan Facility (“New Loan Facility”) and the Main Street Priority Loan Facility (“Priority Loan Facility”) will purchase participations in newly issued loans, and the Main Street Expanded Loan Facility (“Expanded Loan Facility”) will purchase participations in new tranches of loans issued under borrowers’ existing credit facilities
- **The Main Street Lending Program facilities will purchase 95% participations in loans made by eligible lenders to eligible borrowers**
  - An eligible lender is a U.S. federally insured depository institution, a U.S. branch or agency of a foreign bank, a U.S. bank holding company, a U.S. savings and loan holding company or a U.S. intermediate holding company of a foreign banking organization, however, non-bank financial institutions are not eligible lenders
- **The Federal Reserve published revised term sheets for the Main Street Lending Program facilities on July 28, 2020**
  - The term sheets provide initial details regarding eligibility, pricing and other terms (as described below)
  - The initial size of the Main Street Lending Program is $600 billion
  - The Main Street Lending Program will cease purchasing participations on December 31, 2020, unless extended
- **The CARES Act’s restrictions on compensation, dividends and stock repurchases apply to the Main Street Lending Program**
- **The Main Street Lending Program began purchasing participations on July 6, 2020**

# Main Street Lending Program (Eligibility)

- **Borrower eligibility under the Main Street Lending Program**
  - **U.S. Companies** – Companies headquartered in the U.S. with material operations in the U.S. and a majority of its employees based in the U.S.
  - **Small or Medium-Sized Companies** – Companies with up to 15,000 employees or up to $5 billion in 2019 annual revenue
  - **No Participation in Certain Other Programs** – Companies may not participate in multiple of the Main Street Lending Program facilities, and any borrower under the Primary Market Corporate Credit Facility may not borrow under the Main Street Lending Program
    - Companies that receive Paycheck Protection Program loans are eligible for the Main Street Lending Program

- **Each borrower under the Main Street Lending Program must certify, among other things, that**
  - The borrower will follow the CARES Act’s restrictions on stock buybacks, payment of dividends and executive compensation (in each case, until the date that is 12 months after the loan is repaid)
  - The borrower will make “commercially reasonable efforts” to maintain its payroll and retain its employees during the term of the loan
  - The proceeds of the loans will not be used to repay other loan balances before such balances are mandatory and due, and the borrower will not cancel or reduce any existing lines of credit outstanding to the borrower
  - The borrower has a reasonable basis to believe that, as of the date of the borrowing, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period

# Main Street Lending Program (Lending Terms)

- **All loans purchased by the Main Street Lending Program must have certain terms, including:**
  - **Maturity** – 5 years
  - **Interest Rate** – Adjustable rate of LIBOR plus 300 basis points
    - The loans must defer interest payments for one year (unpaid interest will be capitalized)
  - **Amortization** – Amortization deferred for two years, 15% at the end of the third year, 15% at the end of the fourth year and 70% at maturity
  - **Prepayment** – Prepayment permitted without penalty
  - **Security** – Secured or unsecured

- **Other required loan terms vary by Main Street Lending Program facility:**

| | New Loan Facility | Priority Loan Facility | Expanded Loan Facility |
|---|---|---|---|
| **Loan Type** | Term loan | Term loan | Term loan (issued as an upsize tranche of an existing term loan or revolving credit facility) |
| **Date of Origination** | Originated after April 24, 2020 | Originated after April 24, 2020 | Upsized tranche of a facility that was originated on or before April 24, 2020 and has a remaining maturity of at least 18 months |
| **Minimum Principal Amount** | $250,000 | $250,000 | $10 million |
| **Maximum Principal Amount (lesser of)** | (i) $35 million and<br>(ii) an amount that, when added to the borrower's existing outstanding and undrawn available debt, does not exceed four times the borrower's adjusted 2019 EBITDA | (i) $50 million and<br>(ii) an amount that, when added to the borrower's existing outstanding and undrawn available debt, does not exceed six times the borrower's adjusted 2019 EBITDA | (i) $300 million and<br>(ii) an amount that, when added to the borrower's existing outstanding and undrawn available debt, does not exceed six times the borrower's adjusted 2019 EBITDA |

# Federal Reserve Facilities for Large Companies (Overview)

- **The Federal Reserve has announced two new programs to support credit for "large employers"**
  - Primary Market Corporate Credit Facility ("PMCCF")
    - The PMCCF will purchase qualifying bonds directly from investment grade U.S. companies and purchase portions of syndicated loans or bonds of investment grade U.S. companies
  - Secondary Market Corporate Credit Facility ("SMCCF")
    - The SMCCF will purchase in the secondary market corporate bonds issued by investment grade U.S. companies and U.S.-listed ETFs
- **The Federal Reserve published revised term sheets for the PMCCF and the SMCCF on July 28, 2020**
- **The CARES Act's restrictions on stock buybacks, payment of dividends and executive compensation do not apply to the PMCCF and SMCCF**
- **Both the PMCCF and SMCCF are operational as of June 29, 2020**
  - The PMCCF became operational on June 29, 2020
  - The SMCCF began purchasing ETFs on May 12, 2020 and began purchasing corporate bonds issued by individual companies on June 16, 2020
- **The PMCCF and SMCCF will cease purchasing eligible assets no later than December 31, 2020, unless the facilities are extended**

# Federal Reserve Facilities for Large Companies (Eligibility)

- **Eligibility for the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility**
  - **U.S. Companies** – Companies are eligible if created or organized in the U.S. with significant operations in the U.S. and a majority of its employees based in the U.S.
    - U.S. subsidiaries of foreign parents are eligible for the PMCCF and SMCCF if the U.S. subsidiary borrower independently meets the eligibility criteria
  - **Investment Grade** – The applicant must (i) as of March 22, 2020, have been rated at least BBB-/Baa3 by a major nationally recognized statistical rating organization (“Rating Agency”) and, if rated by multiple Rating Agencies, be rated at least BBB-/Baa3 by two or more Rating Agencies and (ii) at the time the PMCCF or SMCCF makes a purchase, be rated at least BB-/Ba3 by a Rating Agency
  - **Additional Requirements**
    - The applicant may not be an insured depository institution, depository institution holding company or subsidiary of a depository institution holding company (as defined in the Dodd-Frank Act)
    - The applicant has not received specific support pursuant to the CARES Act or any subsequent federal legislation
      - Passenger air carriers, cargo air carriers and businesses critical to maintaining national security have received separate assistance under the CARES Act as of the publication of the June 29 term sheet
    - The applicant must satisfy the conflicts of interest requirements of Section 4019 of the CARES Act
      - Section 4019 restricts companies owned by certain U.S. Executive Department officials and Members of Congress, and their family members, from receiving loans
    - The applicant must not have participated in the Main Street Lending Program
- **The maximum amount of instruments that the PMCCF and the SMCCF on a combined basis will purchase with respect to any company is capped at 1.5 percent of the combined potential size of the PMCCF and the SMCCF**
  - As of August 10, 2020, the combined potential size is $750 billion

# Primary Market Corporate Credit Facility

- **The PMCCF will directly purchase bonds from, and purchase portions of syndicated loans or bond issuances of, investment grade U.S. companies**

- **Bond Purchases as Sole Investor**
  - **Required Terms** – The indenture or supplemental indenture is expected to have terms consistent with market conventions and the applicant's most recent prior bond issuance, and will also be required to incorporate a standard set of terms published by the Federal Reserve
  - **Pricing** – Pricing will be issuer-specific and informed by market conditions, with an additional 100 bps facility fee
    - Pricing determinations for sole investor transactions will be made by the PMCCF and are not subject to negotiation
  - **Application Timing** – The application for the PMCCF to purchase bonds as the sole investor should be made approximately two weeks prior to pricing

- **Syndicated Loans and Bonds Purchased Alongside Other Investors**
  - **Participation Level** – The PMCCF will purchase up to 25 percent of a syndicated loan or bond offering
  - **Pricing and Terms** – The PMCCF's participation is expected to be alongside that of other participants, at the same terms and price, with an additional 100 bps facility fee
  - **Application Timing** – After a transaction is announced and shown to prospective purchasers, in the event of insufficient demand (i.e., demand for less than 100 percent of the offering), the underwriters or initial purchasers may approach the PMCCF not later than 1:00 p.m. ET on pricing day and request PMCCF participation in the offering

- **Other Terms and Requirements**
  - **Maturity** – The bonds or loans purchased by the PMCCF must have a maturity of four years or less
  - **Maximum Amounts under the PMCCF** –The maximum amount of outstanding bonds or loans of a company that borrows from the PMCCF may not exceed 130 percent of the company's maximum outstanding bonds and loans on any day between March 22, 2019 and March 22, 2020
  - **Minimum Amounts under the PMCCF** – There is no minimum issuance amount
  - **Refinancing Other Indebtedness** – Applicants may apply to the PMCCF to refinance outstanding debt, beginning three months before the maturity date of such outstanding debt

# Primary Market Corporate Credit Facility (Continued)

- **Certifications required prior to each borrowing under the PMCCF**
  - **CARES Act Certifications** – The CARES Act certifications require the applicant to certify that it meets (i) the U.S. business requirement and (ii) the CARES Act Section 4019 conflicts of interest requirement
  - **Regulation A Certifications** – The Regulation A certifications require the applicant to certify that it (i) is "unable to secure adequate credit accommodations from other banking institutions and the capital markets", (ii) is not insolvent and (iii) has not received any specific support pursuant to Sections 4003(b)(1)-(3) of the CARES Act
    - In certifying whether the applicant is unable to secure adequate credit accommodations from other banking institutions or the capital markets, applicants may consider economic or market conditions in the market intended to be addressed by the PMCCF as compared to normal conditions, including the availability and price of credit
  - **Program-Specific Authorizations Forms** – The applicant must submit a program-specific authorization form, which contains certifications as to transaction-specific information and other PMCCF eligibility criteria

- **The PMCCF will purchase bonds from underwriters as part of an SEC-registered offering or from initial purchasers making a Rule 144A resale**
  - The Federal Reserve has indicated the PMCCF will initially purchase bonds, and as of August 10, 2020, the required documentation and procedures for PMCCF participation in syndicated loan transactions has not yet been published

- **Required Documentation**
  - Bonds sold to the PMCCF, whether as the sole investor or as a purchaser in a syndicated offering, will be documented in a manner customary for SEC-registered bond offerings or bond offerings conducted pursuant to Rule 144A
    - In connection with all bond issuances involving sales to the PMCCF, it is expected that underwriters/initial purchasers will perform customary due diligence and receive customary closing documents such as auditor comfort letters, legal "10b-5" disclosure letters and legal opinions
    - For Rule 144A offerings, the PMCCF expects to receive an offering circular or offering memorandum describing the issuer, the terms and conditions of the bonds, risk factors and other matters typically addressed in such materials

- **To apply for funds from the PMCCF, the underwriters or initial purchasers must contact the investment manager on behalf of the eligible company by email (pmccf@blackrock.com, with a copy to pmccf@ny.frb.org)**

# Secondary Market Corporate Credit Facility

- **The SMCCF will purchase in the secondary market from eligible sellers (i) corporate bonds of individual U.S. issuers, (ii) corporate bond portfolios in the form of exchange-traded funds and (iii) corporate bond portfolios that track a "Broad Market Index"**
  - Eligible sellers are business organized in the U.S. or under the laws of the U.S. with significant U.S. operations and a majority of employees based in the U.S.

- **Corporate Bonds of Individual U.S. Issuers**
  - **Eligible Assets** – The SMCCF will purchase corporate bonds that, at the time of purchase, were issued by an eligible issuer and have a remaining maturity of 5 years or less
  - **Pricing** – The SMCCF will purchase bonds at fair market value in the secondary market
  - **Limits per Issuer** – The SMCCF will not purchase from any issuer more than 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020
  - As of August 10, 2020, the Federal Reserve has not announced how individual issuers may apply for the SMCCF to purchase bonds of such issuer or when these purchases will begin

- **Exchange-Traded Funds**
  - On May 12, 2020, the SMCCF began purchasing U.S.-listed ETFs whose investment objective is to provide broad exposure to the market for U.S. corporate bonds

- **Corporate Bond Portfolios that Track a Broad Market Index**
  - On June 16, 2020, the SMCCF began purchasing eligible corporate bond portfolios that track a "Broad Market Index"
    - The Broad Market Index is made up of all the bonds in the secondary market that have been issued by U.S. companies that satisfy the facility's minimum rating, maximum maturity and other criteria described above, subject to issuer-level caps
    - The Broad Market Index will be recalculated periodically, and the list of bonds that are eligible for purchase will be refreshed to add or remove those bonds that newly meet or no longer meet the eligibility requirements
  - The SMCCF will make Broad Market Index purchases of issuers' bonds without such issuers applying to the SMCCF

# Paycheck Protection Program (Overview)

- **In addition to the above, the CARES Act authorized $349 billion for small business loans through the new Paycheck Protection Program (the "PPP" and loans issued thereunder, "covered loans") and will be administered by the Small Business Administration (the "SBA")**
- **On April 24, 2020, the CARES Act was amended to increase the amount of small business loans authorized under the PPP from $349 billion to $659 billion**
  - On June 5, 2020, certain other terms of the PPP were amended by the Paycheck Protection Program Flexibility Act of 2020 (the "PPP Flexibility Act")
- **Covered loans will be guaranteed by the SBA**
- **Existing SBA lenders have the authority to make and approve loans under the PPP**
- **The CARES Act also provides grant funding to provide education, training and advising to covered small business through entrepreneurial development programs and the Minority Business Development Agency**
- **Applications for PPP loans were accepted through August 8, 2020**
  - The original deadline of June 30, 2020 was extended on July 4, 2020

# Paycheck Protection Program (Eligibility)

- **In addition to small business concerns (as defined in the Small Business Act), small businesses, non-profit organizations, veterans organizations and Tribal organizations are eligible to apply for loans if they employ not more than the greater of:**
  - 500 employees, or
  - A number of employees established by the SBA as the size standard for the industry in which the business operates
- **Sole proprietors, independent contractors and self-employed individuals are also eligible for small business loans upon providing documentation establishing their status as such (including, for example, payroll tax filings reported to the Internal Revenue Service, Forms 1099-MISC and income and expenses from the sole proprietorship)**
- **Businesses that have multiple physical locations, employ not more than 500 employees per physical location and that are assigned a North American Industry Classification System code beginning with 72 (Accommodation and Food Services) are eligible for small business loans**
- **In determining the number of employees, SBA affiliation rules generally will apply (see next slide), although the PPP waives the affiliation rules for certain small businesses:**
  - With no more than 500 employees assigned a North American Industry Classification System code starting with 72 (Accommodation and Food Services);
  - Operating as a franchise and assigned a franchise identifier code by the SBA; or
  - Receiving financial assistance from a company licensed under Section 301 of the Small Business Investment Act of 1958
- **The above mentioned restrictions relating to stock buybacks, payment of dividends and executive compensation applicable to the federal reserve lending programs do not apply to the PPP**

# Paycheck Protection Program (Affiliation Rules)

- **Generally, employees of an affiliate of a small business will also be included in determining the number of employees the small business has**

- **Affiliation will be found if an entity controls or has the power to control another entity or when a third party (or parties) controls or has the power to control both businesses**
  - Control may arise through ownership, management or other relationships between the parties
  - Affiliation based on ownership:
    - Ownership of (or the power to control) more than 50% of an entity's voting equity will be deemed to constitute control
    - A minority shareholder will be found to be in control if that individual or entity has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders
  - Affiliation arising from stock options, convertible securities and agreements to merge
    - Generally, options, convertible securities and agreements to merge are treated as though the rights granted have been exercised
    - Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock in the future are not given present effect
    - Present effect will not be given to parties' ability to divest all or part of an ownership interest to avoid a finding of affiliation
  - Affiliation based on management will be found where the CEO or President (or other parties that control management) of a small business also controls the management of one or more other businesses.
  - Affiliation based on identity of interest will be found where there is an identity of interest between close relatives with identical or substantially identical business or economic interests

- **The SBA has broad authority to find affiliation even if no specific criteria is met**

# Paycheck Protection Program (Use of Proceeds)

- **Proceeds of covered loans may be used for:**
  - Payroll costs
  - Costs of continuation of group healthcare benefits and paid sick, medical or family leave and insurance premiums
  - Employee salaries and commissions
  - Payment of interest on mortgage obligations
  - Rent
  - Utilities
  - Interest on debt obligations incurred before the covered period

- **Covered loans may be used to refinance or repay EIDLs made during the period beginning on January 31, 2020 and ending on the date on which covered loans are made available to the applicant**

- **Covered loans and guarantees made by the SBA are nonrecourse to the SBA (unless the loan proceeds are misused)**

# Paycheck Protection Program (Key Terms/Characteristics)

- **Applicant needs to deliver a certification as to the need for the covered loan in the context of economic uncertainty created by COVID-19, that the proceeds from the loans will be used in compliance with the PPP and that the applicant has not applied for or received other funds from the SBA for the same purpose**

- **Waivers of fees usually owed to SBA and the personal guarantee and collateral requirement**

- **Waiver of requirement that credit be available to the borrower elsewhere typically applicable to SBA loans; certification in good faith of the necessity of the PPP loan still required**
  - Although the CARES Act has suspended the requirement that borrowers be unable to obtain credit elsewhere, borrowers nevertheless need to certify in good faith that the current economic climate makes a PPP loan request necessary to support its ongoing operations
  - In particular, in the Frequently Asked Questions dated as of April 24, 2020, the SBA and Treasury Department stated that "it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification"
    - On April 28, 2020, the SBA extended this guidance to include "private companies with adequate sources of liquidity to support the business's ongoing operations"

- **Covered loans will bear interest at 1%**
  - Payments of principal, interest and fees are required to be deferred until the date the borrower's loan forgiveness amount is determined

- **Initially under the PPP, covered loans had a 2-year maturity; the PPP Flexibility Act extends the maturity of loans originated on or after June 5, 2020 to 5 years**
  - The maturity of PPP loans existing as of June 5 can be extended to 5 years if the lender and the borrower agree to extend the loan, though there is no obligation of either party to extend the maturity

# Paycheck Protection Program (Forgiveness)

- **Recipients are eligible for forgiveness of indebtedness on covered loans in an amount equal to the sum of the below expenses over the period beginning on the date of the loan and ending 24 weeks after such date or December 31, 2020, whichever is earlier (the “Covered Period”):**
  - Payroll costs
  - Payment of interest on covered mortgaged obligations
  - Payment on covered rent obligations
  - Covered utility payments
- **Initially, SBA guidance provided that not more than 25% of the amount forgiven may be for non-payroll costs; the PPP Flexibility Act requires that, in order for the loan to be eligible for maximum forgiveness, not more than 40% of the original loan amount be used for non-payroll costs**
  - Amount of loan forgiveness cannot exceed the principal amount of financing under the loans
- **The amount of covered loans forgiven may be reduced based on a borrower’s reduction of employment or compensation levels during the Covered Period relative to certain prior periods**
  - However, any reduction in the number of full-time employees or wages between February 15, 2020 and December 31, 2020 will be omitted. The intention behind this exemption is to encourage re-hiring employees
  - Additionally, the PPP Flexibility Act provides the reduction in employment may be disregarded if the borrower is able to document an inability to (i) rehire individuals who were employees on Feb. 15, 2020, and an inability to hire similarly qualified employees for unfilled positions on or before Dec. 31, 2020, or (ii) return to the same level of business activity as it was operating at before Feb. 15, 2020, due to compliance with regulatory guidance from certain specified authorities related to standards for sanitation, social distancing or any other worker or customer safety requirement related to COVID-19
- **Submission of an application seeking loan forgiveness is required**
- **Recipients who received covered loans prior to June 5, 2020 may elect for the Covered Period to end on the date that is 8 weeks after the date of such loan**

# Cravath


**Worldwide Plaza**
825 Eighth Avenue
New York, NY 10019-7475
+1-212-474-1000 Phone
+1-212-474-3700 Fax

**CityPoint**
One Ropemaker Street
London EC2Y 9HR England
+44-20-7453-1000 Phone
+44-20-7860-1150 Fax