

The CARES Act: What Does It Mean for Financial Institutions?

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief and Economic Security Act (the “[CARES Act](#)”). While the CARES Act includes a variety of provisions, including, among other things, unemployment benefit expansion and emergency funding of public health care initiatives, it also contains a number of provisions applicable to financial institutions, as summarized below.

Small Business Administration – Paycheck Protection Program

A new small business lending program is created under the Small Business Administration (the “[SBA](#)”) to originate “paycheck protection loans.” Approximately \$349 billion has been appropriated by Congress to support the program.

- **Covered Period.** February 15, 2020 through June 30, 2020 (the “[Covered Period](#)”)
- **Eligible Borrowers.** Any small business, business concern, nonprofit organization, veterans organization or eligible tribal business concern is eligible to receive a loan if such business employs not more than the greater of:
 - (i) 500 employees; or
 - (ii) if applicable, the size standard in number of employees established by the SBA for the industry in which the business operates. Please note that the SBA size standards currently in effect, which can be found by [clicking here](#), range up to 1,500 employees depending upon the industry and sector. Potential borrowers should consult this list to determine eligibility.

The paycheck protection program is also available to sole proprietors, independent contractors and eligible self-employed individuals.

- **Affiliation Waivers.** During the Covered Period, the provisions applicable to affiliations, which generally require that proposed borrowers include the employees of any affiliate when calculating the number of its employees, are waived with respect to the following affiliations: (i) any business with not more than 500 employees that, as of the date on which the loan is disbursed, is assigned a North American Industry Classification System (NAICS) code beginning with 72 (Accommodation and Food Services); (ii) any business operating as a franchise that is assigned a franchise identifier code by the SBA; and (iii) any business that receives financial assistance from a small business investment company. If an affiliate does not fall within one of these exemptions, the employee count would aggregate the borrower’s and all nonexempt affiliates’ employees for purposes of determining the borrower’s employee count.
- **Additional Considerations Impacting Eligibility of Borrowers.**
 - Eligible lenders must consider the following criteria when reviewing an application: (i) whether applicant was in operation on February 15, 2020; (ii) whether applicant had employees for whom it paid salaries and payroll taxes; and (iii) whether applicant paid independent contractors, as reported on a Form 1099-MISC.
 - Borrowers will also be required to make the following good faith certifications: (i) the uncertainty of current economic conditions makes the loan request necessary to support ongoing operations; (ii) the borrower will use the loan proceeds to retain workers and maintain payroll or make mortgage, lease and utility payments; (iii) the borrower does not have another paycheck protection loan application pending for a loan duplicative of the purpose and amounts applied for; and (iv) from February 15, 2020 to

December 31, 2020, the borrower has not received another paycheck protection loan duplicative of the purpose and amounts applied for.

- The mere fact that the applicant has also received an Economic Injury Disaster Loan (“EIDL”) does not prohibit it from applying for a paycheck protection loan.
- The SBA’s standard requirement that an applicant is “unable to obtain credit elsewhere” is waived.

- **Eligible Lenders.**

- *SBA-Approved Lenders.* All current SBA-approved lenders are approved and deemed to have been delegated authority by the SBA to originate paycheck protection loans.
- *Other Lenders.* Lenders, including both financial institutions and non-bank lenders, which are not currently SBA-approved must seek the SBA’s and the Department of Treasury’s prior approval before participating in the program. We anticipate that the SBA will issue guidance on how these approvals will be granted. The SBA will review any request to participate in the program to determine whether the lender has the necessary qualifications to process, close, disburse and service loans made with the guarantee of the SBA. Lenders interested in becoming a SBA-approved lender can find additional information by [clicking here](#).

- **Characteristics of Paycheck Protection Loans.**

- *SBA-Guaranteed.* These loans are 100% guaranteed by the SBA. Under current existing SBA programs, guarantees are typically limited to 75% to 85% of the originated amount.
- *Maximum Loan Amount.* The maximum loan amount is the lesser of (i) \$10 million or (ii) the sum of (a) 2.5 times the borrower’s average total monthly payroll costs incurred during the one year period prior to the date on which the loan is made, or at the election of the borrower, during the period from March 1, 2019 through June 30, 2019, plus (b) the outstanding amount of any EIDL extended by the SBA to the borrower between January 31, 2020 and the date on which the loan is made available to the borrower to refinance such EIDL.
- *Interest Rate.* Will not exceed 4% annually.
- *Allowable Uses.* Include: (i) payroll costs; (ii) costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave and insurance premiums; (iii) employee salaries, commissions or similar compensation; (iv) payments of interest on any mortgage obligation (excluding any prepayment of or payment of principal on a mortgage obligation); (v) rent; (vi) utilities; and (vii) interest on any other debt obligations that were incurred before the Covered Period.
- *Disaster Loans.* Any EIDL previously extended to a borrower by the SBA may be refinanced provided that the disaster loan was originated after January 31, 2020.
- *Nonrecourse.* Loans are extended on a nonrecourse basis. No personal guarantees or other collateral will be required.
- *Fees.* None.
- *Reimbursement of Processing Fees.* The SBA will reimburse the lender within five days after origination and disbursement of the loan. The amount of reimbursement is: (i) 5% for loans under \$350,000; (ii) 3% for loans over \$350,000 and less than \$2 million; and (iii) 1% for loans over \$2 million.
- *Prepayment Penalty.* None.
- *Transferability and Assignment.* Loans are eligible to be sold into the secondary market. The SBA will not be permitted to collect any fees associated with the sale of a guarantee into the secondary market.

- **Regulatory Relief for Financial Institutions.**

- *Risk-Weighting of Paycheck Protection Loans.* A financial institution that originates or otherwise holds (through a secondary market transaction) paycheck protection loans will be able to assign zero risk-weighting for purposes of calculating its applicable capital requirements.

- *Temporary Relief from TDR Accounting.* A financial institution that modifies a paycheck protection loan that would otherwise be considered a troubled debt restructuring (“TDR”) will not be required to comply with the applicable accounting treatment for TDRs, until such time and under such circumstances that the appropriate federal banking regulators determine appropriate.

- **Loan Forgiveness.**

- *Application for Loan Forgiveness.* Borrowers will be eligible for loan forgiveness upon application to the lender that is servicing the loan. The application is expected to include, among other things, documentation verifying the number of full-time employees on payroll, pay rates, payroll tax filings, state income tax, payroll and unemployment insurance filings and documentation verifying payments on covered mortgage and lease obligations. In addition, the borrower must provide a certification to the lender as to the truthfulness and accuracy of such information, including that the use of all funds was in accordance with the program. No loan forgiveness will be approved if the borrower has failed to keep and submit the applicable documentation. All decisions on applications for loan forgiveness are required to be made by the lender within 60 days.
- *Amounts of Eligible Loan Forgiveness.* A borrower will be eligible for forgiveness in an amount equal to the sum of the following costs incurred and payments made during the Covered Period: (i) payroll costs; (ii) any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation); (iii) any payment on any covered rent obligation; and (iv) any covered utility payment.
- *Reductions in Amounts Eligible for Loan Forgiveness.* In general, the amount of loan forgiveness a borrower is eligible to receive may be reduced (but not increased) based on the following:
 - Employee Count Reduction. The average number of full-time equivalent employees (“FTEs”) of the borrower during the 8-week period following receipt of the loan is *less than* the average number of FTEs of the borrower, at the borrower’s option, during either the period from (i) February 15, 2019 to June 30, 2019, or (ii) January 1, 2020 to February 29, 2020.

Specifically, in such instance, the amount of eligible loan forgiveness would be reduced by the quotient obtained by dividing (i) the average number of FTEs per month of the borrower during the 8-week period following extension of the loans *by* (ii) at the borrower’s election, (a) the average number of FTEs per month of the borrower beginning on February 15, 2019 and ending on June 30, 2019; or (b) the average number of FTEs per month of the borrower beginning on January 1, 2020 and ending on February 29, 2020. The quotient would then be multiplied by the amount of eligible loan forgiveness.

This potential reduction in loan forgiveness provision is designed to encourage borrowers to retain as many employees as possible.
 - Salary Amount Reduction. The amount of eligible loan forgiveness will also be reduced by the amount of any reduction in total salary or wages of any employee that is in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the Covered Period.

A covered employee for purposes of this provision is an employee who did not receive salary or wages in excess of \$100,000 on an annualized basis during any single pay period in 2019.
 - Exemption for Rehires and Elimination of Salary Reductions. The amount of loan forgiveness is to be determined without regard to a reduction in the number of FTEs or a reduction in the salary of 1 or more employees of a borrower that occurs between February 15, 2020 and 30 days after the enactment of the CARES Act, if such reduction in the number of FTEs and/or reduction in salary is eliminated by June 30, 2020. For clarity, this incentivizes the borrower to rehire and/or restore salary by June 30, 2020.

- *Loans Not Forgiven.* With respect to a loan that has a remaining balance after reduction based on the loan forgiveness amount, (i) the remaining balance will continue to be guaranteed by the SBA and (ii) the loan will have a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness.
- *Tax Exemption.* If a borrower obtains loan forgiveness, the amount would not be considered taxable for federal income tax purposes.
- *Remittance.* Not later than 90 days after the date on which the amount of forgiveness is determined, the SBA will remit to the lender an amount equal to the amount of forgiveness, plus any interest accrued through the date of payment.
- *Secondary Market Process.* A lender authorized, or, at the discretion of the SBA, a third party participant in the secondary market, may report to the SBA an expected forgiveness amount on a paycheck protection loan or on a pool of paycheck protection loans of up to 100% of the principal on the loan or pool amount, respectively. The SBA will purchase the expected forgiveness amount not later than 15 days after the date on which the SBA receives a report.

Small Business Administration – Emergency Economic Injury Disaster Loan Grants

The CARES Act also appropriates \$10 billion to the SBA to enable it to expand its current EIDL program. Specifically, applicants that are awaiting EIDL approval may request the SBA to advance an amount of funds equal to \$10,000, which amount would be in addition to any EIDL amount being sought by the applicant. Below is a summary of this program.

- **Covered Time.** January 31, 2020 through December 31, 2020 (the “Covered Time”).
- **Eligible Borrower.** The following types of entities are eligible to participate under the EIDL grant program: (i) a business with not more than 500 employees; (ii) any individual who operates under a sole proprietorship, with or without employees, or as an independent contractor; (iii) a cooperative with not more than 500 employees; (iv) an eligible Employee Stock Ownership Plan with not more than 500 employees; and (v) an eligible tribal small business concern.
- **Determining Eligibility of Borrowers.** The SBA will review and may approve an applicant's EIDL application based on the following criteria: (i) solely on the credit score of the applicant and will not require an applicant to submit a tax return ; and (ii) use alternative appropriate methods to determine an applicant's ability to repay. The SBA's standard requirement that an applicant is "unable to obtain credit elsewhere" is waived.
- **Advance Characteristics.**
 - *Maximum Advance Amount.* Up to \$10,000 if requested by an applicant. The advance will be made within three days of the SBA receiving the applicant's application.
 - *Permissible Uses of Advance Amount.* An advance may be used to address any allowable purpose for an EIDL, including providing paid sick leave to employees, maintaining payroll to retain employees, meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains, making rent or mortgage payments and repaying obligations that cannot be met due to revenue losses.
 - *Personal Guarantee Waiver.* All personal guarantee requirements waived on loans and advances under \$200,000 during the Covered Time.
 - *Existing Business Concern Waiver.* The SBA's requirement that an applicant must have been in business for the one year period before the disaster occurred is waived, except for a business that was not in operation on January 31, 2020.
 - *Repayment.* No repayment will be required of any advanced amounts, even if subsequently denied an EIDL.

Department of Treasury Loan Programs

Pursuant to the provisions of the CARES Act, \$454 billion has been appropriated to the Department of Treasury to establish various loan programs through the Board of Governors of the Federal Reserve System (the “Federal Reserve”). The purpose of these programs will be to “make loans and loan guarantees to, and other investments in, programs or facilities established by the Federal Reserve for the purpose of providing liquidity to the financial system that supports lending to eligible businesses, States or municipalities.” The CARES Act authorizes the Federal Reserve to create these lending programs but does not include a specific time line for issuing rules and establishing the programs.

While the details of these various loan programs have not been set forth in detail, and will be subsequently set forth in rules issued by the Federal Reserve, below is a summary of these programs as provided in the CARES Act.

- **General Provisions of Federal Reserve Programs or Facilities.** The Federal Reserve may create lending programs or facilities pursuant to which it may lend directly to eligible borrowers or provide funding to financial institutions or other lenders who then extend direct loans to eligible borrowers. Eligible borrowers under any of the programs established by the Federal Reserve will be required to comply with, among other things, prohibitions, for the life of the loan and one year thereafter, on (i) repurchasing equity securities (or buybacks), (ii) issuing dividends; and (iii) utilizing various employment compensation arrangements.

In addition, eligible borrowers will be subject to restrictions contained in Section 13(3) of the Federal Reserve Act, including without limitation, requirements on loan collateralization and borrower solvency. Eligible borrowers must also be organized in the U.S., have significant operations in the U.S. and have a majority of employees in the U.S.

- **Midsized Business Lending Program.** In particular, the CARES Act specifies that the Federal Reserve may establish a Midsized Business Lending Program to providing financing to banks and other lenders that make direct loans to eligible businesses including, but not limited to, nonprofit organizations, with between 500 and 10,000 employees. These direct loans will be subject to an annualized interest rate that is not higher than 2%. For the first six months after any such direct loan is made, or for such longer period as the Department of Treasury may determine, no principal or interest will be due and payable.

In addition to the restrictions noted above, an eligible borrower in the Midsized Business Lending Program will also be subject to (i) a prohibition on outsourcing or offshoring jobs for the term of the loan and two years thereafter, (ii) a prohibition on abrogating existing collective bargaining agreements for the term of the loan and two years after completing repayment thereof and (iii) a requirement to remain neutral in any union organizing effort for the term of the loan.

Eligible borrowers must also certify the following: (i) the uncertainty of economic conditions as of the date of the application makes necessary the loan request to support the ongoing operations of the recipient; (ii) the funds it receives will be used to retain at least 90% of the recipient’s workforce, at full compensation and benefits, until September 30, 2020; (iii) the recipient intends to restore not less than 90% of the workforce of the recipient that existed as of February 1, 2020; and (iv) the borrower will restore all compensation and benefits to the workers of the borrower no later than four months after the termination date of the public health emergency.

- **Other Programs.** Additionally, the CARES Act authorizes the Federal Reserve to create a “Main Street lending program,” which would “support lending to small and midsized businesses,” and a “Government Participant” lending program, which would support lending to states and municipalities; however, the CARES Act does not contain specific details on these programs.

We will provide further updates as the Department of Treasury and the Federal Reserve issue proposed rules and guidance concerning these lending programs.

Temporary Relief for Community Banks – Community Bank Leverage Ratio

In fall 2019, the Federal Reserve, the Federal Deposit Insurance Corporation (the “FDIC”) and the Office of the Comptroller of the Currency (the “OCC”) (collectively, the “federal banking regulators”) issued a final rule to implement the Community Bank Leverage Ratio (“CBLR”) framework. This framework provides that banks that satisfy the criteria of a “qualifying community banking organization,” including meeting the requirement of maintaining a CBLR in excess of 9%, and which

choose to opt-in to the CBLR framework, will only be required to report the CBLR ratio, instead of the other capital ratios that they are currently required to report (i.e., Total Risk-Based Capital Ratio, Common Equity Tier-1 Capital Ratio and Tier-1 Risk-Based Capital Ratio).

The CARES Act directs the federal banking regulators to issue an interim rule that lowers the CBLR from 9% to 8%.

The interim rule will be effective from the date the interim rule is published until the earlier of the termination of the national emergency or December 31, 2020.

Temporary Relief for Community Banks – Troubled Debt Restructurings

From March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the termination of the national emergency, all banks will have the option to elect either or both of the following:

- (i) to suspend the requirements under U.S. generally accepted accounting principles (“GAAP”) for loan modifications related to the COVID–19 pandemic that would otherwise be categorized as a TDR; and/or
- (ii) to suspend any determination of a loan modified as a result of the effects of the COVID–19 pandemic as being a TDR, including impairment for accounting purposes. The federal banking regulators are required to defer to any determination concerning suspension made by an applicable bank.

If a bank elects a suspension(s) noted above, the suspension (i) will be effective for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and (ii) will not apply to any adverse impact on the credit of a borrower that is not related to the COVID–19 pandemic.

Temporary Relief for Community Banks – Current Expected Credit Losses

With the impending implementation of the Financial Accounting Standards Board Accounting Standards Update No. 2016–13 (Measurement of Credit Losses on Financial Instruments), commonly referred to as CECL requirements, there has been much anxiety in the industry as to the likely impact on banks’ credit operations.

Pursuant to the CARES Act, no bank, bank holding company or any affiliates thereof will be required to comply with the CECL requirements during the period beginning after the date the CARES Act is enacted until the earlier of December 31, 2020 or the termination of the national emergency.

National Banks – Temporary Lending Limit Waiver

As national banks are aware, a national bank is limited in the amount of credit that it may extend to one borrower. Specifically, a national bank may extend credit to a borrower in an amount that does not exceed (i) 15% of the unimpaired capital and surplus of the national bank, plus (ii) an additional 10% of the national bank’s unimpaired capital and surplus provided that such amount in excess of 15% of the national bank’s unimpaired capital and surplus is fully secured by readily marketable collateral having a market value equal to such additional amount (subject to certain exceptions).

The CARES Act provides the OCC with the power to exempt any “transaction or series of transactions” from the above lending limits that is in the public interest and consistent with the purpose of the lending limits.

In addition, the CARES Act specifically exempts extensions of credit to nonbank financial companies from the lending limits. A “nonbank financial company” is defined as including: (i) a foreign nonbank financial company; (ii) a U.S. nonbank financial company; and (iii) nonbank financial companies supervised by the Federal Reserve. These exceptions will be effective from the enactment of the CARES Act and lasting only until the earlier of termination of the national emergency or December 31, 2020.

Although loan-to-one-borrower limits in various states, including Illinois, are typically broader than the OCC’s lending limit, the waiver may place a national bank in a more favorable position than that of a state-chartered bank during this continuing national emergency. However, it is uncertain at this time whether a state-chartered bank can utilize its state’s wild card provision/power (if applicable) to enable the state-chartered bank to take advantage of this new national bank lending limit exemption.

FDIC – Reauthorization of the FDIC’s Debt Guarantee Authority

The CARES Act authorizes the FDIC to implement a debt guarantee program that includes guaranteeing deposits held by banks and also “noninterest-bearing transactions accounts.” This authority appears to be a reauthorization of the FDIC’s Temporary Liquidity Guarantee Program implemented in October 2008 during the 2008–2009 financial crisis. We will provide additional information regarding this program once the FDIC has issued guidance on this program.

Forbearance, Foreclosure Moratorium and Consumer Rights

- **Forbearance.** A borrower with a “federally backed mortgage loan” (defined below) experiencing a financial hardship due, directly or indirectly, to the COVID–19 emergency may request forbearance for up to 180 days, which may be extended for an additional period of up to 180 days, regardless of delinquency status, by (i) submitting a request to the borrower’s servicer and (ii) affirming that the borrower is experiencing a financial hardship during the COVID–19 emergency. During the period of forbearance, no fees, penalties or interest beyond the amounts scheduled or calculated (as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract) are permitted to accrue.
- **Foreclosure Moratorium.** In addition, a servicer of a federally backed mortgage loan may not initiate any judicial or non-judicial foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sale for not less than the 60-day period beginning on March 18, 2020.
- **Multifamily Properties with Federally Backed Mortgage Loans.** For multifamily properties subject to a federally backed multifamily mortgage loan, borrowers experiencing a financial hardship due, directly or indirectly, to the COVID–19 emergency may also request a 30-day forbearance, provided they were current on their payments as of February 1, 2020. A servicer will extend the forbearance for up to two additional 30-day periods, provided that the request is made by the borrower during the applicable period and made at least 15 days prior to the end of the current forbearance period. However, a multifamily borrower that receives forbearance may not during the forbearance period (i) evict or initiate the eviction of a tenant from a dwelling unit located on the applicable property or (ii) charge any late fees, penalties or other charges for late payment of rent.
- **Definition of Federally Backed Mortgage Loan.** A “federally backed mortgage loan” includes any loan which is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from 1- to 4-families that is (i) insured by or under, (ii) subject to a guarantee of or (iii) purchased or securitized by, the Federal Housing Administration, the National Housing Act, the Housing and Community Development Act, the Department of Veteran’s Affairs, the Department of Agriculture, the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

Fair Credit Reporting Act – Consumer Credit Considerations

From January 31, 2020 and ending on the later of (i) 120 days after enactment of the CARES Act or (ii) 120 days after the national emergency is terminated, if a furnisher of information makes an accommodation with respect to one or more payments on a consumer credit account, and the consumer makes the payments or is not required to make payments pursuant to the accommodation, the furnisher will be required to (i) report the credit account as current or (ii) if the credit account was delinquent before the accommodation, (a) maintain the delinquent status during the period in which the accommodation is in effect and (b) if the consumer brings the credit account current during the accommodation period, the creditor must report the credit account as current.

If you would like to discuss the matters addressed in this bulletin, please contact **James M. Kane** at (312) 609-7533, **Daniel C. McKay, II** at (312) 609-7762, **James W. Morrissey** at (312) 609-7717, **Jennifer D. King** at (312) 609-7835, **Juan M. Arciniegas** at (312) 609-7655, **Mark C. Svalina** at (312) 609-7741 or your Vedder Price attorney.