

Emergency Loans, Loan Guarantees, and Other Investments Under the COVID-19 Stimulus Legislation

Evaluating Options and Preparing to Seek Assistance

The U.S. Congress appears close to finalizing the scale and scope of stimulus legislation to address the economic crisis caused by the COVID-19 pandemic. Although its final shape remains uncertain, it is highly likely to provide for one or more lending programs, loan guaranty programs, and other financing programs administered by the federal government to direct funding to industries, municipalities and consumers substantially affected by the pandemic.

Such programs are not without precedent and, like other aspects of the government response, are likely to raise issues that have much in common with issues related to the federal government's efforts to allocate and disburse funds on a broad and rapid scale during the financial crisis in 2008. The centerpiece of that response was the Emergency Economic Stabilization Act, under which the U.S. Secretary of the Treasury purchased preferred stock in over 700 banking organizations in order to recapitalize the U.S. banking industry. Although the recipients of government assistance in the COVID-19 stimulus legislation will not be limited to financial institutions, the financial crisis and the experience of financial institutions that sought and received assistance under EESA may nonetheless be instructive for companies as they consider seeking funding under the programs currently being considered by Congress. The following summarizes key considerations for companies that are interested in requesting funds under the COVID-19 stimulus legislation, reflecting lessons learned from the financial crisis in 2008.

1. EVALUATE APPLICATION MATERIALS THAT MAY BE REQUIRED AND THE PROCESSES AND CONTROLS NEEDED TO PREPARE THEM

The stimulus legislation will likely require the U.S. Secretary of the Treasury to publish application procedures and minimum requirements for available funds within a certain amount of time after passage of the legislation. For context, the application materials for the Capital Purchase Program ("CPP") under the Troubled Asset Relief Program ("TARP") in EESA in 2008 were streamlined and little, if any, negotiation of the relevant transactional documents was permitted. The federal banking agencies' supervisory experience with the applicant banks and pre-existing access to substantial information about applicants enabled those agencies to review applications and exercise judgment quickly about the suitability of individual institutions to receive funds.

The process to be developed under the COVID-19 stimulus legislation in all likelihood will require a modified and more burdensome approach for applicants for funding that do not have that kind of supervisory relationship with the relevant decision-makers. The circumstances will require the government to act quickly and, at the same time, minimize its risk of default. This may mean that application requirements will be detailed and that the opportunity for negotiation will be, as it was under EESA, limited or non-existent. It may also mean that government actors may seek to obtain and rely on attestations and certifications provided by the applicant as to key criteria, which in turn will require effective internal controls designed to mitigate the heightened risks associated with delivering those attestations and certifications.

The most likely and rapid recipients of funds will be those whose applications can quickly and clearly demonstrate compliance with all of the requirements established by the government's procedures. Accordingly, applicants should pay close attention to the application materials and strategize about the best approach to demonstrating that they satisfy the requirements, including the development of any requisite processes and controls. In 2008, participation in the CPP was in practice limited to banks already in stable condition; in 2020, an applicant for stimulus funds may not be in stable financial condition given the current economic climate and effect of the pandemic but should endeavor to show that the financial assistance is prudent and repayment risk is tolerable to the U.S. Department of the Treasury. Applicants also should comply with any filing deadlines for requests since extensions of time may be unavailable.

2. ANALYZE CONDITIONS ON FEDERAL ASSISTANCE

Assistance under the stimulus legislation will likely require applicants to comply with a number of conditions and constraints on their operations. For example, the final form of legislation may require recipients of assistance to maintain pre-pandemic employment levels and prohibit recipients from share repurchases and dividends. By analogy, participation in a number of financial crisis-era programs required financial institutions to comply with restrictions relating to executive compensation and the payment of dividends, among other requirements. Applicants should fully understand how the COVID-19 legislation's conditions might affect their current and future business strategy, and how obtaining assistance may constrain their access to capital markets or other funding, their compensation structure, and potential flexibility in other aspects of their operations, over both the near- and long-term.

3. UNDERSTAND OPTIONS FOR GOVERNMENT ASSISTANCE AND THEIR MERITS RELATIVE TO DIFFERENT BUSINESS NEEDS AND CIRCUMSTANCES

Based on discussions to date, it appears likely that the economic stabilization and assistance provisions of the COVID-19 stimulus legislation will contain one or more of the following: (i) U.S. Treasury Department authority to provide government assistance through loans, guarantees, and investments directly to certain, specified industries, (ii) additional funding that the Treasury Department may use to support (e.g., through equity investments that effectively backstop potential losses) either existing or new special emergency liquidity programs established by the Federal Reserve pursuant to its independent and pre-existing authority under section 13(3) of the Federal Reserve Act; and (iii) expansion of Small Business Administration lending programs to provide small businesses with access to additional types of government-guaranteed credit. The merits of each of these paths to government assistance will depend heavily on a business's economic position and needs, as will the relative attractiveness of that business as a potential applicant under each program.

A lesson of similar efforts in the 2008 financial crisis is that the government will seek to maximize the impact of assistance throughout the financial system and the broader economy, and limit its own costs in doing so. For example, the rules that govern the Federal Reserve's use of its emergency assistance authority require assistance programs to be "broad-based," with participation limited only to borrowers that are solvent. These goals may translate into decision-making that prioritizes assistance to firms that will have a "multiplier" or "ripple" effect; thus, a firm that can demonstrate its ability to leverage a dollar of assistance, rather than simply using it to absorb losses, may have a stronger case for assistance. Firms also should be able to show a history of good credit and sound business fundamentals that suggests an ability to withstand the current crisis. Similarly, the government also will impose conditions on the use of the funds and conditions on an applicant's operations as a whole, as described above.

4. ANALYZE THE IMPACT OF FEDERAL ASSISTANCE ON EXISTING SHAREHOLDERS AND CAPITAL STRUCTURE

Applicants should carefully analyze, before deciding to obtain financial assistance, the effect that assistance may have on their existing shareholders and capital structure, including potential consequences under all applicable federal and state securities laws. For example, during the financial crisis, some banks considered entering the CPP program but ultimately chose not to do so out of concern that the long term payments to the Treasury Department and other limitations would adversely affect their market valuations, limit dividends, and impede efforts to raise private capital. Similarly, even for banks that did choose to enter the CPP program under EESA, those that were publicly-held financial institutions were required to prepare and file with the SEC resale registration statements to facilitate resales by the government of equity securities received upon exercise of warrants granted to the government as part of the capital infusion. If similar "equity kicker" structures are included in forthcoming financial assistance programs, companies seeking funding will need to consider the potential impact of such a filing.

5. MANAGE ONGOING REGULATORY AND REPORTING EXPECTATIONS

Ensuring strict compliance with any conditions imposed in connection with federal assistance will be critical to mitigating compliance risk and reputational risk associated with the assistance. To the extent assistance is paid out over time, recipients will need to demonstrate compliance on an ongoing basis in order to receive future payments. Recipients should therefore be prepared to demonstrate that they have, or promptly will put in place, (i) procedures that will enable them to track their compliance over the assistance period and, as needed or required, report their compliance to the government, as well as (ii) internal controls sufficient to achieve compliance in practice. Moreover, the agencies involved in stimulus activities will expect intense Congressional scrutiny of the agencies' administration and oversight of the programs and accordingly are likely to establish through regulation, order, or guidance new reporting requirements that show the impact of any assistance.

6. TAKE STEPS TO MITIGATE RISK OF SUBSEQUENT INVESTIGATIONS AND LITIGATION REGARDING USE OF FINANCIAL ASSISTANCE

Many banks that accepted TARP funding were subject to audits and investigations by the Office of the Special Inspector General for TARP ("SIG TARP"). Banks also were subject to congressional and other public scrutiny regarding their use of TARP funds.

The COVID-19 stimulus legislation contains comparable forms of oversight with respect to financial assistance, including the establishment of a Special Inspector General's Office and a Congressional Oversight Panel. This creates a risk of, among other things, criminal and civil enforcement against institutions that accept funds under the stimulus legislation without having appropriate controls in place to protect against fraud and comply with conditions attached to the funds. Of note following the financial crisis in 2008, SIGTARP investigations resulted in enforcement actions against nine financial institutions and in the successful criminal prosecutions of 51 bank officers and executives.

In addition to scrutiny from the Special Inspector General and Congress, recipients of assistance that are supervised financial institutions will be subject to ongoing supervision by their primary regulators regarding their receipt and use of federal assistance. Recipients of financial assistance that are not part of the regulated financial system should expect to be held accountable through ongoing reporting requirements and, potentially, through government investigation and/or audit. And, recipients of assistance could face civil litigation, including under the False Claims Act, in connection with any certifications, attestations, or reports that are required to be made to the federal government.

Recipients are best positioned to demonstrate compliance and manage enforcement and litigation risk if they: (i) carefully vet all applications for assistance and other submissions to the federal government and (ii) establish appropriate policies and procedures before or upon receipt of assistance. Of course, processes put in place in the midst of a crisis will not always be perfect and, should issues arise, recipients of funds can demonstrate good faith by reviewing, correcting, and, where appropriate, self-reporting at the earliest reasonable opportunity.

7. CONSIDER INTERPLAY BETWEEN STIMULUS-BASED FINANCIAL ASSISTANCE AND OTHER FEDERAL RESERVE PROGRAMS

Companies considering direct government assistance under the stimulus legislation should evaluate the possible benefits of other recovery programs such as those administered by the Federal Reserve. The Federal Reserve has, for example, established a Commercial Paper Funding Facility, which is intended to facilitate the issuance of commercial paper by eligible issuers, and also has said that it will soon announce a Main Street Business Lending Program to support lending to eligible small-and-medium sized businesses to complement SBA lending.

Other, more specialized programs may hold particular interest for certain types of businesses. The recently announced Term Asset-Backed Securities Loan Facility would benefit companies that rely on asset-backed forms of funding. Two programs, the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility, are designed for large employers and involve the Federal Reserve lending directly to issuers of corporate debt or purchasing such debt directly from the issuers or on the secondary markets. Although most of these programs are directed to banks, as intermediaries, to facilitate underwriting, disbursement, and servicing of financial assistance made more broadly available to small businesses and other commercial companies, it is critical for all applicants of financial assistance to understand the terms that apply to the programs, as loans that are eligible for liquidity support under these programs are likely to be significantly easier and less expensive to obtain, and assets that are eligible for liquidity support under these programs are likely to be significantly easier to sell quickly and at reasonable value.

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