DORSEY
always ahead

Bank Counsel Roundtable—
The Stimulus Bills, Federal Regulatory Agencies and the Federal Reserve—
Bank Challenges and Opportunities

April 2, 2020

Joseph T. Lynyak III
Nick Vlietstra
Tom Scanlon
Ken Logsdon

DORSEY
always ahead

Welcome

Nicholas A. J. Vlietstra

Dorsey Speakers

Joseph T. Lynyak III
Partner
lynyak.joseph@Dorsey.com
310.386.5554

Ken Logsdon
Partner
logsdon.ken@dorsey.com
(801) 933-7362

Tom Scanlon
Of Counsel
scanlon.tom@dorsey.com
(202) 442-3506

Agenda

- **A focus on the economic stimulus provisions of Titles I and IV of the CARES Act**
  - **Title I—**
    - **The current SBA Program**
    - **The Paycheck Protection Program**
  - **Title IV—the Corona Virus Economic Stabilization Act of 2020**
    - **Section 4003—Emergency Relief and Taxpayer Protections**
  - **Consumer Protections**
  - **Miscellaneous Provisions**
  - **Bank Risk Management Considerations**
  - **Bank Regulatory and Federal Reserve Monetary Policy Actions**

Additional Materials on the Stimulus Act at: https://www.dorsey.com/

A Few Initial Thoughts and Observations

Title I and Title IV Issues

- **Primary Issues—**
  - **Will the Treasury use the current paradigm for SBA lending?**
  - **Will the Treasury modify SBA application, processing and funding protocols to radically ramp-up loan origination?**
  - **How will new Title IV program interface between Treasury and the FRB?**

The Current SBA Model

- SBA-approved lenders originate and hold
- Lender receives SBA insurance
- If same process applies—issues are as follows:
  - Regulation and program guidance
  - Scalability
  - Application and documentation
  - Funding
  - Lender capacity
  - Timing/expiration of program
  - Counterparty considerations

CARES Act General Implementation Issues

- Regulations and program instructions slowly trickling out
  - Numerous questions remain
- Scalability
  - Probable 50,000 to 75,000 applicants for new SBA program alone
    - Estimates for combined SBA programs >100,000
  - Likely to overwhelm systems which are not designed for scale
- Application and documentation
  - Loan terms and conditions not yet written
  - Possibly post on an official government website and incorporate by reference?
  - Should a bank engage in due diligence in any event?
- Funding
  - Current SBA process requires a lender to extend the credit and fund
  - Back-ended reimbursement or repurchase program potentially complicated
- Lender capacity
  - Exempts SBA loan from risk-based capital—but not other capital requirements
  - Banks may exceed lending capacity due to capital without immediate funding under either Title I or Title IV
- Timing of programs
  - Expiration of programs not realistic (i.e., June 30, 2020)
- Counterparty limitations
  - Existing representations and warranties may prohibit/limit new credit extensions

Title I and SBA Programs—Ken Logsdon

Title I SBA Programs

- Title I creates a new SBA program under Section 7(a) of the SBA Act
  - The Paycheck Protection Program or "PPP"
  - Funding is set at approximately $350 billion
  - Uses the concept of a "covered loan"
  - Uses the concept of a "covered period"
    - February 15, 2020 to June 30, 2020
- The current Section 7(a) and 7(b) programs remain in place and are available to businesses under existing rules
  - Funding is increased to $50 billion
  - Underwriting and compliance requirements more conservative than as contemplated for the PPP
  - A lender must be an approved SBA lender

PPP Loan Terms

- Eligible borrower is—
  - Any business entity (including "small business concerns")
  - Non-profit organizations
  - Veterans organizations
  - Tribal business concerns
  - Certain independent contractors and self-employed individuals (requires additional documentation)
  - *And* employs the greater of:
    - < 500 employees, including part-time employees; or
    - If applicable, SBA's size standards for specific industry
- Maximum Loan amount equal to the lesser of—
  - 2.5 x monthly average of all employee salaries (capped per employee at $100,000) and benefits, or
  - $10,000,000

PPP Loan Terms

- Loan proceeds may be used for—
  - Payroll costs
  - Health care
  - Employee salaries
  - Mortgage payments (excluding principal payments)
  - Rent
  - Utilities
- "Trickle-down" effect will benefit banks and mortgage lenders and investors

PPP Loan Terms

- A covered loan is non-recourse (maybe)
- SBA personal guaranty and collateral requirements waived
- No requirement that credit cannot be obtained elsewhere
- A 10-year term from date a PPP borrower applies for loan forgiveness
- Interest rate not to exceed 4%
- Payment deferral
  - Lenders must defer payments of principal, interest and fees for a period between 6 months and 1 year
- Borrower requirements
  - A certification of impact by COVID-19 required
  - Undertaking to limit use of funds to identified permitted payments
  - No duplicative applications or payments permitted
  - Required to be in business as of February 15, 2020
  - Has employees or independent contractors and has paid salaries and payroll taxes
  - Provides KYC compliance information

PPP Loan Fees

- Some banks have identified PPP lending as potentially creating a valuable revenue stream—
  - 5% for loans up to $350,000
  - 3% for loans >$350,000 but <$2,000,000
  - 1% for loans $2,000,000 and greater
    - A $100,000 origination fee is above market for many commercial loan products
- PPP loan interest rate up to 4% per annum
- Servicing fees and charges not addressed
- No SBA fee

PPP Loan Forgiveness

- Loan principal to be forgiven—computed on specified expenses paid during the 8-week period commencing on the date a covered loan is originated (the "covered period")
- During the covered period, payment made in the following categories will be forgiven—
  - Payroll costs
  - Mortgage interest payments
  - Covered rent payments
  - Covered utility payments
- The SBA will pay amounts forgiven to the lender/holder
  - Computation of reimbursement subject to the numbers of employees and salary reductions/adjustments, etc.
- Supporting documentation required

PPP Loan Administration

- Participating PPP lenders authorized to make and approve covered loans (expedited loan approval)
- Lenders not required to be an SBA-approved lender
  - SBA clarification needed
- Secondary market contemplated
  - Trust certificate guarantees capped at $100,000,000,000
- Bank regulatory capital requirement for a covered loan set at 0% risk-weight
  - Unless waived by Bank Regulators—all other capital requirements continue to apply
- Modification of a covered loan after March 13, 2020 does not qualify as a troubled debt restructuring ("TDR") for regulatory and reporting purposes
- Fees—
  - Lenders to be paid origination fees by the SBA for loan origination
  - Agents for borrowers limited to fees as set by the SBA (and must be paid out of lender's fee)

Treasury Speaks

- On March 31, Treasury issued some guidance for the PPP—including the following clarifications—
  - Estimates that 75% of funds will be used for employee payroll
  - Forgiveness of debt based upon maintaining or quickly rehiring employees
  - Borrower agents are permissible—fees paid out of lender fees
  - Minimal underwriting required—
    - Borrower was in operation as of February 15, 2020
    - Borrower paid salaries and payroll taxes
    - Verification of average payroll taxes
    - Compliance with AML know your customer rules
  - Simple loan application provided
- See: treasury.gov/cares

Title IV and Treasury/FRB Stimulus—Joe Lynyak

Title IV—The Corona Virus Economic Stabilization Act of 2020

- $500 Billion
  - $25 billion to passenger air carriers
  - $4 billion to cargo carriers
  - $17 billion to critical national security businesses
  - $454 billion to be used either by the Treasury or by the FRB or by both
- Language of Act provides enormous flexibility to Treasury to structure loan and guaranty programs
  - Subject to enhanced oversight
  - Subject to the Government's right to take stock or warrants
- Numerous employee and consumer protections now included

Loan Terms—General

- Loan term—no more than 5 years
- Loans *cannot* be forgiven (compare to Title I new SBA PPP program)
- No repurchase of securities until 12 months after repayment
- No payment of dividends until 12 months after repayment
- No RIFs until September of 2020 greater than 10% of workforce
- Certifications by a business required

Equity and Warrants

- Treasury must take equity or warrants if loan made to an airline or a national security business
  - All other loans at the discretion of the Treasury
  - If necessary—senior debt with a reasonable rate of return will be allowed
  - No voting power for the securities taken

Loan Terms—Mid-Sized Businesses

- Coverage: 500 to 10,000 employees
  - Includes non-profits
- Interest rate—no higher than 2 percent per annum
- No interest or principal payments for first 6 months of loan
- Retention or recall of 90% of workforce required
- Business must be domiciled in US
- Not involved in a bankruptcy proceeding
- No dividends permitted until repayment
- No repurchase of most securities
- No outsourcing of jobs until 2 years after repayment
- No union contract abrogation

Title VI Loan Issues

- Do Title IV loans have to be secured?
  - Probably not—but a lender may require security
- Issuance of procedures required within 10 days following the adoption of the Act
  - Highly unlikely

DORSEY™ always ahead

BANK IMPLEMENTATION—THE CARES ACT—APRIL 2, 2020

Special Terms for Airlines and National Security Businesses

- A freeze for 1 year on individual compensation over $425,000
  - Additional limitations on senior level compensation over $3,000,000
- Severance pay limited to no more than twice annual total compensation for certain individuals

DORSEY™ always ahead

BANK IMPLEMENTATION—THE CARES ACT—APRIL 2, 2020

Title IV Loan Administration

- Loan Administration
  - Loan and servicing fees not addressed in Title I (unlike Title I)
  - Favorable interest rate for Mid-Sized businesses (not to exceed 2%)
    - Interest rate for larger businesses not addressed
  - Treasury can hire staff to administer program
  - Treasury can hire third-party fiscal agents to implement programs
  - Robust Inspector General authority to review program
    - Obligatory reports to be made to Congress
    - Congressional Oversight Commission (new)
  - Authority under Title IV expires December 31, 2020

Consumer—Tom Scanlon

Consumer

- Mortgage Forbearance
  - Covers Agency (*i.e.,* GSE, FHA, etc.) purchased or insured mortgages
    - Non-Agency mortgages not covered
  - Requires a servicer to forbear for 180 days upon request and affirmation by a borrower of a COVID-19 emergency
    - Must be extended another 180 days at the request of the borrower
    - No fees or charges permitted beyond contract terms
    - Minimal documentation/support required to be provided by a borrower to a servicer
- Judicial and Non-Judicial Foreclosure Moratorium
  - Moratorium for 60 days beginning as of March 18, 2020
  - Includes judicial and non-judicial foreclosures, and motions for judgment or order for sale actions

Consumer

- Forbearance for multifamily borrowers
  - Similar to single family loans
  - Applies to Agency multifamily loans
  - 30-day forbearance up to an additional 60 days
  - Not obligatory and forbearance can be revoked
  - No evictions for tenants during forbearance period
- Moratoriums on evictions
  - Applies to single family and multifamily Agency loans
  - No eviction action for 120 days as of effective date of Act, plus 30 days after expiration of moratorium period

Consumer

- **Reporting under the Fair Credit Reporting Act**
  - **Generally aims to allow a consumer to have his or her credit account reported as "current" if the consumer conforms to terms of an agreed upon "accommodation"**
  - **Furnisher (*i.e.*, the creditor) and the consumer may agree upon an accommodation:**
    - **Defer one or more payments**
    - **Forbear on delinquent account(s)**
    - **Modify a loan or contract**
    - **"Any other assistance or relief granted to [an affected] consumer"**
  - **Applies during the "covered period," which starts on January 1, 2020 and runs to the end of the national emergency**
  - **Cure for delinquent account—If the credit account had been delinquent (say, on January 15), then the consumer may bring the account current, and the furnisher must report accordingly**

Miscellaneous—Joe Lynyak

Miscellaneous

- National bank lending limit at 12 USC 84 temporarily modified until December 31, 2020
- Community Bank Leverage Ratio set at 8%
  - Grace period granted for a community bank that falls below that level until December 31, 2020
- Suspension of CECL standards until December 31, 2020 or end of national emergency
  - FASB Update No. 2016-13 (Measurement of Credit Losses on Financial Instruments)
  - The Banking Regulators have announced a further regulatory extension of CECL, which permits extending out the complete implementation of the rule for 5 years
    - https://www.fdic.gov/news/news/press/2020/pr20041b.pdf

Miscellaneous

- 12 USC 5612(f) modified
  - FDIC authorized to engage in a direct loan and guaranty program
  - Impliedly only to benefit FDIC-insured institutions
  - FDIC guaranty may now be treated as a debt program
- Conflicts of Interest—
  - Prohibition on the President, the Vice President, heads of federal agencies or a member of Congress to receive financial assistance
    - 20% ownership, includes family members attribution
- Bankruptcy Code modified
  - Amends Chapter 13 to exclude payments made under the National Emergencies Act with respect to the coronavirus disease from "disposable income" in Chapter 13 plans
  - The effect of these provisions—
    - Prevents defaults under existing Chapter 13 plans
    - Prevent creditors of Chapter 13 debtors from claiming the emergency payments made by the government to those debtors or from having those payments interfere with a Chapter 7 debtor's right to file a liquidation case

Risk Management Considerations

Risk Management Considerations

- Issuance of Treasury regulations
- Complexity of Treasury regulations
- SBA back-end audits and disqualification/payment adjustments
- Bank staffing resources, training and technology
- Program duration
- Revenue projections
- Client selection
- Capital and lending capacity

Bank Regulatory Advice and Guidance

DORSEY always ahead

Categories of Regulatory Advice

- **Safety and Soundness**
  - OCC
  - FDIC
  - CFPB
  - FRB
- **Monetary Policy**
  - FRB

DORSEY always ahead

Banking Agency

- This is a credit crisis—not a liquidity crisis (yet)
- Pronouncements from the Banking Regulators to date have been similar to advice provided after natural disasters
- Announcements have predominantly been issued by the FFIEC or joint agency announcements
- The focus initially only addressed—
  - Emergency preparedness
  - Operations and customer accommodations
  - Call Report and other regulatory filings
- Regulatory relief now being issued and (probably) more to come

Emergency Preparedness

Interagency Statement on Pandemic Planning

- Phases: Planning, preparedness responding and recovering (a component of "business impact analysis")
  - A preventative program
  - A documented strategy
  - A comprehensive framework of facilities, systems, or procedures to continue critical operations
  - A testing program
  - An oversight program to ensure ongoing review and updates

Bank Operations

- Alternative Service Options (*e.g.*, branch operations) should be considered
- No notice for branch closing necessary
- Reasonable accommodation to be made for filing bank regulatory reports
  - Call Reports
  - Applications (make them electronic)
  - FinCEN filings

Customer Accommodation

- Joint Statement on Retail Customer Activities in Response to COVID-19
- Banks should consider waiving certain fees--
  - ATM fees for customers and non-customers
  - Overdraft fees
  - Late payment fees on credit cards and other loans
  - Early withdrawal penalties on time deposits
  - Easing restrictions on cashing out-of-state and non-customer checks
  - Expanding the availability of other short-term, unsecured credit products for creditworthy borrowers
  - Increasing credit card limits for creditworthy borrowers
  - Providing alternative service options to customers in light of limited ability to access branches; and
  - Offering payment accommodations, such as allowing borrowers to defer or skip payments or extending the payment due date, which would avoid delinquencies and negative credit bureau reporting, caused by COVID-19-related issues

Default and Forbearance

- Joint Agency Statement—Sunday March 22
- Working with borrowers affected by COVID-19—
  - Agencies will not criticize banks for prudent loan modifications and will not direct supervised institutions to automatically categorize COVID-19-related loan modifications as troubled debt restructurings (“TDRs”)
  - FASB has confirmed that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs
- Modifications to prudential underwritten home loans and not past due or carried in nonaccrual status will not be considered restructured or modified for risk-based capital rules
- Loan deferrals not otherwise past due when the deferral is granted are not deemed past due
- Softens supervisory reaction for regulatory reporting of past due and nonaccrual status for loan modification
- An ALLL must still be established per existing regulatory advice

Enhanced Troubled Debt Restructuring (“TDR”) Relief

- CARES Act liberalizes exception to TDR as announced by the Banking Agencies
  - More flexible than Bank Regulatory Agency guidance on March 22
  - Ends December 31, 2020
  - Suspends GAAP accounting for TDRs
  - Applies to loan modifications not more than 30 days delinquent (a more liberal standard)

FRB Monetary Policy

FRB Monetary Policy

- In the last three weeks, the Federal Reserve has expanded or created new credit facilities
- Authority based upon Section 13(3) of Federal Reserve Act to protect the national economy
- Actions include—
  - Establishing a temporary repurchase agreement facility for foreign and international monetary authorities (FIMA Repo Facility)
  - Expanded authority for the operations of the Federal Open Market Committee
  - Exchange Stabilization Fund (ESF) in amount of $300 Billion, will provide $30 billion in equity to these facilities.
  - The Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance
  - The Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds

FRB Monetary Policy—FRB Actions

- Actions include—
  - The Term Asset-Backed Securities Loan Facility (TALF), to support the flow of credit to consumers and businesses
  - Expansion of the Money Market Mutual Fund Liquidity Facility (MMLF)
  - Primary Dealer Credit Facility
  - State and Municipal Money Market Liquidity Facility
  - Coordination with Central Banks for U.S. Dollar Swap Facilities
  - Interim Final Rule on Computation of Risk-Based Capital
  - Creation of a Main Street Business Lending Program
  - Lowering of the Federal Funds Rate to 0% to ¼%
  - Bank reserve requirement lowered to 0% as of March 26, 2020

Questions?

Thank you!

Kenneth Logsdon

Partner
logsdon.ken@dorsey.com
(801) 933-7362

Ken's clients look to him for counsel on the structuring, negotiating, and administering of complex commercial, secured, and asset-based financings.
His practice spans a wide variety of transaction sizes and types, from sole lender financings to large market, broadly syndicated credit facilities for equity sponsor portfolio acquisitions and financings.

Joseph T. Lynyak III

Partner
Lynyak.joseph@Dorsey.com
310.386.5554

Joe Lynyak is a financial services partner in Dorsey & Whitney's Financial Services Practice. Focusing his practice on the regulation and operation of financial service intermediaries, he provides counsel on strategic planning, application and licensing, legislative strategy, commercial and consumer lending, examination, supervision and enforcement and general corporate matters. He has extensive expertise across a comprehensive range of issues before federal and state regulatory agencies such as the Federal Reserve Board, OCC, FDIC, NCUA, CFPB, SEC, FTC and California and New York Banking Departments. Mr. Lynyak's representative clients include foreign and domestic banks, savings associations, credit unions, holding companies and mortgage banking companies.

Tom Scanlon

Of Counsel
scanlon.tom@dorsey.com
(202) 442-3506

Tom is experienced in counseling clients on ways to adapt financial products or services to changing rules, advising on transactions, and helping to address supervisory actions by the bank regulatory agencies, including the Consumer Financial Protection Bureau.

In both private practice and government service, Tom has worked on a range of bank regulatory issues and on projects relating to payments systems. He also has advised fintech companies on compliance with federal and state laws that apply to a money transmitter.

While serving at the Federal Reserve Board, Tom worked on a series of interagency rules; while serving at the Department of the Treasury, Tom worked as the principal attorney of the Department's team to help draft the Consumer Financial Protection Act of 2010 (Title X of the Dodd-Frank Act). He has worked with several types of clients to help shape public policy for financial regulation, such as by drafting legislative proposals and preparing comment letters for proposed rules.

Tom has extensive experience advising on issues that involve the Federal Reserve's regulations, the Federal Deposit Insurance Act, the National Bank Act, the Electronic Fund Transfer Act, the privacy rule (the Bureau's Regulation P), the Fair Credit Reporting Act, the Military Lending Act, financial data aggregation, and vendor-management standards.

Nicholas A. J. Vlietstra

Partner
vlietstra.nicholas@dorsey.com
(612) 492-6031

Nick Vlietstra is a Partner in Dorsey's Finance & Restructuring Group. Nick has expertise in consumer banking law and regulation, government investigations and inquiries, workplace investigations, and working with regulators, including the Federal Reserve, the OCC, the CFPB, and state banking agencies. He also has extensive experience in advising banks and their executive management on a wide range of high-stakes and sensitive legal issues involving legal and reputational risk, complex litigation, and nuanced business and consumer disputes. Nick has also tried cases in state and federal court and in commercial and labor arbitrations.

Prior to joining the Firm, Nick was U.S. Bancorp's Deputy General Counsel and previously its Chief Consumer Banking Counsel and its Chief Litigation Counsel. In his twelve years there, Nick advised and led legal support for all of its consumer banking and payments businesses, including consumer lending, branch banking, credit and prepaid cards, residential mortgage, and collections. Nick also oversaw all of the company's litigation, employment and investigation matters nationwide, for all lines of business.

Nick also serves as general counsel to the Dorsey & Whitney Trust Company.