

## [Securities Regulation Daily Wrap Up, STRATEGIC PERSPECTIVES—What the \\$2T CARES Act means for the securities industry, \(Mar. 27, 2020\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The CARES Act provides aid to many sectors of the economy and workers while also imposing limits on share buybacks, executive compensation, and capital distributions for businesses receiving aid.

Congress passed a massive economic aid package for businesses and workers that is intended to sustain the economy during the COVID-19 pandemic. The Coronavirus Aid, Relief, and Economic Security (CARES) Act ([H.R. 748](#)) includes provisions on a variety of topics that can touch upon securities markets, including executive compensation limits and restrictions on share buybacks and the payment of dividends. The Senate passed the aid bill by a [vote](#) of 96-0 while the House approved the bill by voice vote. The White House [announced](#) that President Trump had signed the bill.

**Executive compensation limits.** Section 4003 within Subtitle A of Title IV of Division A of the aid bill, also called the Coronavirus Economic Stabilization Act of 2020, establishes a \$500 billion fund from which the Treasury Secretary can extend loans and other guarantees to eligible businesses, states, and municipalities. A subset of these funds is dedicated to the airline industry, subject to limits on these companies' executive compensation.

For example, Section 4004 of the aid bill imposes limits on executive compensation of officers and other employees regarding loans and guarantees extended to passenger air carriers, cargo air carriers, and businesses critical to national security. Specifically, the Treasury Secretary can extend a loan or guarantee if, as of the date an agreement is executed and a date one year after the loan or guarantee is no longer outstanding if:

- No officer or employee with total compensation greater than \$425,000 in 2019 (other than under an existing collective bargaining agreement) will receive (1) compensation in excess of total compensation received in 2019; or (2) severance or other termination benefits exceeding two times the maximum total compensation received in 2019.
- No officer or employee with 2019 total compensation over \$3 million will receive more than: (1) \$3 million; and (2) 50 percent of the excess over \$3 million of total compensation received in 2019.

The provision defines "total compensation" to include salary, bonuses, stock awards, and other financial benefits. Subtitle B of Title IV, titled Air Carrier Worker Support, contains a related executive compensation provision in Section 4116 that mirrors Section 4003. The provision in Section 4116 applies for the two-year period beginning March 24, 2020 and ending March 24, 2022.

With respect to the \$454 billion in Federal Reserve Board facilities authorized under Section 4003(b)(4), there are a number of limits, including compliance with the executive compensation limits contained in Section 4004. However, Section 4003 allows the Treasury Secretary to waive these limits to protect the interests of the federal government. The Treasury Secretary must testify to Congress about any waivers.

**No buybacks or capital distributions.** Section 4003 of the Coronavirus Economic Stabilization Act of 2020 sets forth a lengthy list of terms and conditions for loans and other guarantees made to passenger air carriers, cargo air carriers, and businesses critical to national security, including limits on share buybacks, dividends, and other capital distributions. Eligible businesses, for example, may not repurchase their equity shares until 12 months after the loan or guarantee is no longer outstanding. The provision, however, does not apply to buybacks subject to a contractual obligation that was in effect as of the date of enactment. Similarly, an eligible business may not pay dividends or make other capital distributions regarding its common stock until 12 months after the loan or guarantee is no longer outstanding.

Moreover, similar requirements regarding buybacks and dividends and other capital distributions apply to eligible businesses receiving aid under Fed facilities. However, the Treasury Secretary can waive such requirements for these entities if "necessary to protect the interests of the Federal Government." Although this description is focused on buybacks and dividends provisions in the aid package, the relevant provision granting the Treasury Secretary authority to waive certain requirements also addresses compliance with the executive compensation provisions contained in Section 4004, which also could be waived. The Treasury Secretary must be available to testify to Congress about the reasons for granting any waiver.

**Security for loans.** Under Section 4003, loans and guarantees extended to passenger air carriers, cargo air carriers, and businesses critical to national security must be made to companies that are listed on a national securities exchange and which provide Treasury with a warrant or equity interest in the business. Other eligible businesses that receive loans or guarantees must provide Treasury with either warrants or equity interests in the business or with a senior debt instrument.

**Conflicts of interest.** Section 4019 of the Coronavirus Economic Stabilization Act of 2020 addresses conflicts of interest related to relief that can be granted under Title IV of Division A of the aid bill. Specifically, an entity seeking to engage in a transaction under Section 4003 must, before the transaction has been approved, have its principal executive officer and its principal financial officer certify to the Treasury Secretary and the Fed that the entity is eligible for the transaction and that the entity is not a covered entity.

"Covered entity" means an entity in which a covered individual has a controlling interest (the provision states that securities held by two or more related persons are to be aggregated). "Controlling interest" means owning, controlling, or holding 20 percent of the vote or value of the outstanding amount of any class of equity interest. "Covered individual" means the president, vice president, executive department heads, members of Congress, and these individuals' spouses, children, and sons- or daughters-in-law. Members of Congress also include members of the Senate, the House, Delegate to the House, and the Resident Commissioner of Puerto Rico.

**Troubled debt restructurings.** Section 4013 within the Coronavirus Economic Stabilization Act of 2020 addresses troubled debt restructurings (TDRs). Specifically, a financial institution may elect to: (1) suspend U.S. GAAP requirements for loan modifications related to the COVID-19 pandemic that would otherwise be categorized as TDRs; and (2) suspend any determination of a loan modification due to the COVID-19 pandemic as a TDR, including impairment for accounting purposes.

The suspension provision applies to modifications of loans that are not more than 30-days past due as of December 31, 2019. But the provision does not apply to the adverse impact on a borrower's credit that is not related to the COVID-19 pandemic.

Moreover, the provision states that an appropriate federal banking agency of a financial institution must defer to the financial institution's determination regarding suspension. Financial institutions should keep records regarding the volume of affected loans, and federal banking agencies may collect data on loans for supervisory purposes.

The "applicable period" for the provision is March 1, 2020 until the earlier of December 31, 2020, or the date that is 60 days after the end of the of March 13, 2020 presidential declaration of a national emergency.

**Credit losses.** Section 4014 within the Coronavirus Economic Stabilization Act of 2020 provides that insured depository institutions, bank holding companies, and their affiliates need not comply with the Financial Accounting Standards Board's new standard regarding current expected credit losses (CECL) contained in FASB Update [No. 2016-13](#) (*Measurement of Credit Losses on Financial Instruments*). FASB [extended](#) the compliance dates for some types of entities in October 2019. The relief contained in the aid bill begins on the date of enactment and continues until the earlier of December 31, 2020, or the date the March 13, 2020 presidential declaration of a national emergency ends.

**Fed meetings.** Section 4009 within the Coronavirus Economic Stabilization Act of 2020 provides the Federal Reserve Board with relief from the requirements of the Government in the Sunshine Act. Specifically, the Fed may conduct meetings without satisfying 5 U.S.C. §552b if the Fed's chairman determines in writing that unusual

and exigent circumstances exist. The provision applies beginning from the date of enactment until the earlier of the end of the of March 13, 2020 presidential declaration of a national emergency or December 31, 2020. The Fed must keep records of votes and the reasons therefor during this period.

**Congressional oversight of Title IV.** Section 4020 within the Coronavirus Economic Stabilization Act of 2020 establishes the Congressional Oversight Commission to provide accountability for implementation of Title IV of Subtitle A of the aid bill by Treasury and the Fed, including efforts to achieve economic stability due to the COVID-19 pandemic. The Congressional Oversight Commission must report at 30-day intervals on: (1) the use of authorities; (2) the impact of loans on the well-being of people in the U.S., the U.S. economy, financial markets, and financial institutions; (3) the extent to which information about transactions under the subtitle contributed to market transparency; and (4) the effectiveness of loans of minimizing long-term costs to and maximizing benefits for taxpayers.

**Retirement funds.** Internal Revenue Code (IRC) Section 72(t) imposes an additional 10-percent tax on early distributions from qualified retirement plans. The provision also contains a number of exceptions that do not apply the additional tax to certain distributions such as distributions made on or after the date on which an employee attains age 59.5.

Section 2202 within Subtitle B of Title II of Division A of the aid bill provides that IRC Section 72(t) is inapplicable to coronavirus-related distributions of up to \$100,000 in any taxable year. Repayments can be made during the 3-year period starting one day after receipt of a distribution up to the amount of the distribution. A distribution from a non-IRA is treated as an eligible rollover distribution and as having been made within 60 days of the distribution.

"Coronavirus-related distribution" means a distribution from an eligible retirement plan: (1) made on or after January 1, 2020 and before December 31, 2020; (2) to an individual diagnosed with COVID-19 by a CDC-approved test or whose spouse or dependent was similarly diagnosed; or (3) who experiences adverse financial consequences from COVID-19 (e.g., being quarantined, furloughed, laid off, having reduced work hours, being unable to work due to a lack of child care, the closing of or reduced hours of a business owned or operated by the individual, or other factors determined by the Treasury Secretary).

Section 2203 further provides for a temporary waiver of the minimum required distribution requirement contained in IRC Section 401(a)(9).

**Business interest deduction.** IRC Section 163(j) allows a business interest deduction in a taxable year in an amount not exceeding the sum of: (1) the taxpayer's business interest income; (2) 30 percent of the taxpayer's adjusted taxable income; and (3) the taxpayer's floor plan financing interest. "Business interest" means interest paid or accrued for a trade or business debt but does not include investment interest.

Section 2306 within Subtitle C of Title II of Division A of the aid bill adds IRC Section 163(j)(10) to provide for a special rule for taxable years beginning in 2019 and 2020. Specifically, the 30-percent limit is raised to 50 percent. Special rules apply to partnerships. A taxpayer can elect out of the new provision, but the decision to elect out can be revoked only with the consent of the Treasury Secretary. The provision is effective to taxable years beginning after December 31, 2018.

**Bankruptcy.** Title I of the aid bill, the Keeping American Workers Paid and Employed Act, contains a key definition for purposes of the Bankruptcy Code. Specifically, Section 1113 temporarily modifies the definition of "debtor" contained in 11 U.S.C. §1182(1) such that "debtor" means a person engaged in commercial or business activity with aggregated noncontingent liquidated secured or unsecured debts as of filing a petition (or the date of an order of relief) of up to \$7.5 million of which at least 50 percent arose from the debtor's commercial or business activities. However, "debtor" does not include: (1) Exchange Act reporting companies; (2) affiliates of issuers as defined in Exchange Act Section 3; or (3) certain groups of affiliated debtors.

With respect to the reference to Exchange Act Section 3 and the definition of "affiliate of an issuer," Exchange Act Section 3(a)(8) defines "issuer" and although affiliates are mentioned in numerous other Exchange Act Section 3 definitions, there is no specific statutory definition of "affiliate of an issuer" as referenced in the aid

bill. However, Securities Act Rules 144(a)(1) and 405 do contain definitions of "affiliate of an issuer" and use similar language to refer to "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer."

Section 1113 applies only to cases under the bankruptcy code commenced on or after enactment. The provision sunsets one year after enactment and will then revert to its current definition of "debtor," which means "small business debtor."

**Criminal justice provisions.** Section 15002 in Division B of the CARES Act provides that certain federal criminal proceedings may be conducted via video teleconferencing or via telephone conferencing if video teleconferencing is not reasonably available. Proceedings that could be impacted include: (1) detention hearings; (2) initial appearances; (3) preliminary hearings; (4) waivers of indictment; (5) arraignments; (6) probation and supervised release revocation; (7) pretrial release revocation; (8) appearances under Federal Rule of Criminal Procedure 40; and (9) misdemeanor pleas and sentences. Likewise, video teleconferencing or telephone conferencing may be used to conduct felony pleas and sentencings under Federal Rules of Criminal Procedure 11 and 32, respectively.

The provision also includes requirements about the findings to be made before courts use video teleconferencing or telephone conferencing. A cornerstone of the provision is that a defendant must, after consultation with counsel, consent to the use of video teleconferencing or telephone conferencing.

The authorization for the use of video teleconferencing or telephone conferencing terminates on the earliest of 30 days after the presidential emergency declaration ends or when the U.S. Judicial Conference finds that emergency conditions no longer materially affect the functioning of federal courts or a particular district court.

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