Congressional Oversight Commission Scrutinizes National Security Loans

By Sean Fulmer

Original post here.

In the Congressional Oversight Commission ("COC") November Report, the members of the Commission focused on questions surrounding the U.S. Treasury Department's ("Treasury") $700 million loan to YRC Worldwide, under the auspices of the Coronavirus Aid, Relief, and Economic Security (CARES) Act provision for loans to businesses critical to national security. Treasury Secretary Steven Mnuchin appeared before the commission at a public hearing on December 10 to discuss the national security loan program. Additionally, the report provided an update on the various CARES Act lending facilities.

Loan to YRC Worldwide

The CARES Act allocated up to $17 billion to the Treasury Department for loans and loan guarantees to businesses "critical to maintaining national security." While the Treasury administers the program, it defers to the Department of Defense or the Director of National Intelligence to designate businesses as crucial to national security. At the time of the COC November report, the Treasury has disbursed $735.9 million in loans to 11 businesses deemed critical to national security, with YRC Worldwide accounting for $700 million (95%) of that amount.

YRC Worldwide is the fifth largest trucking company in the United States and employs over 30,000 individuals, the majority of them unionized. Prior to the pandemic, YRC operated at a loss and struggled with low liquidity levels, as a result of significant pension commitments, and poor credit ratings, which can be seen in Figure 1.

Figure 1	Prior to COVID-19	Start of COVID-19	During COVID-19
Credit Rating	B2	Caa1	Caa1
Speculative Grade Liquidity	SGL-3	SGL-4	SGL-3

On April 29, YRC entered into an agreement with the Treasury for a $700 million loan, which is separated into two tranches as described in Figure 2. The Treasury also received a 29.6% equity stake in YRC to compensate for the risk of the loan. That equity stake was worth $40 million at the end of July and $67 million at the time of the COC report. The financial advisor to the Treasury determined that this equity position would produce a total return of 12% per annum if the Treasury holds it for the entire four-year period of the loan.

Figure 2	Tranche A	Tranche B
Amount	$300 million	$400 million
Interest Rate	LIBOR + 3.5%	LIBOR + 3.5%
Cash or Payment-in-kind interest	Split between 1.5% cash interest and 2.0% payment-in-kind interest	All cash interest
Due Date	September 30, 2024	September 30, 2024
Lien Position	Third-priority lien on assets	First-priority lien only on equipment purchased using Tranche B funds

Financial Concerns

The COC notes that the interest rate offered to YRC by the Treasury is significantly lower than that on loans provided to YRC prior to the pandemic, and lower than the market rate offered to borrowers with similar credit ratings during the pandemic. Beyond the terms of the loan, the COC questions the assessment of the 29.6% equity stake in YRC performed by the Treasury's financial advisor, since YRC faces serious risks of defaulting on its debt obligations in the near future. Furthermore, the lien position obtained by the Treasury puts it at a less favorable position compared to YRC's other creditors who share first- and second-priority liens on YRC assets. Finally, YRC has several obligations that come due prior to the Treasury loan on September 30, 2024. The COC cited all of these issues as reasons for concern that the Treasury investment in YRC is significantly more risky than the Treasury has estimated.

In response to the concerns of the COC, the Treasury acknowledged that the loan to YRC is risky, which should be expected in a crisis. However, the Treasury believes that it has appropriately protected itself from needless risk. The equity stake received by the Treasury, originally worth $30 million in June, is now worth about $75 million, which could cover potential losses. During the COC hearing, Secretary Mnuchin mentioned the possibility of selling the loan in the summer of 2021 for a profit. Additionally, the Treasury loan is secured by $546 million in excess existing collateral (78% collateralization level). If YRC draws on the entirety of Tranche B ($400 million), the total collateral securing the Treasury loan will be $866 million (124% collateralization level), since Treasury holds a first-position lien on equipment purchased with Tranche B funds at a 20% discount.

Administration Concerns

Beyond the credit risk of the YRC loan, the COC also continued to question the designation of YRC as critical for national security. The Department of Defense stated that YRC is the largest single provider of less-than-truckload services for it, delivering food and electronic supplies to the military throughout the country. The COC questioned whether these deliveries can be classified as critical for national security, to which the Defense Department replied that it is important for the military to have access to the supplies it needs. The Defense Department informed the COC that it does not have any contingency plans for a possible bankruptcy of YRC.

The COC will address these issues at a hearing on December 17 at which Undersecretary Ellen Lord of the Department of Defense and Director of National Intelligence John Ratcliffe will appear.

In a recent related report, the Government Accountability Office (GAO) also raised questions about the YRC loan. According to the GAO, Treasury officials did not follow the standard loan approval process established for evaluating applications. The report also points out that Treasury approved the YRC loan three months earlier than any other national security loan, and that it was executed before the first-stage or second-stage loan application evaluation procedures were finalized. Treasury has said that this was due to the urgency of YRC's financial situation. The GAO report also notes that the Treasury staff that negotiated the loan were not the staff that had worked on the creation of the loan program.

Congressional Hearing

On December 10, the COC hosted Treasury Secretary Mnuchin at a public hearing to discuss the CARES Act national security loans program. The members of the COC focused on the riskiness of the YRC loan, albeit from different angles. Representative French Hill (R-Ark.) disagreed with the Treasury's assessment of YRC's collateral and future financial health. Commissioner Bharat Ramamurti (a Democrat appointee) questioned whether Secretary Mnuchin knew of YRC's significant debt obligations to Apollo Global Management, a private equity firm that has also loaned significant amounts to a business controlled by the Kushner family; the Secretary denied any such knowledge. Senator Patrick Toomey (R-Pa.) noted that several of the loans to other businesses designated as critical to national security went to startups in amounts larger than their 2019 revenues. In response to criticisms of the disparity in application approval times, Secretary Mnuchin said that the department needed to implement several major loan programs simultaneously and that lawmakers on both aisles asked him to expedite the YRC loan.

The hearing also included brief discussions of Secretary Mnunchin's decision to withdraw support from five CARES Act credit facilities established by the Federal Reserve under its Section 13(3) emergency authority, which the COC has jurisdiction over (the Primary Market Corporate Credit Facility, Secondary Market Corporate Credit Facility, Municipal Lending Facility, Main Street Lending Program, and Term Asset-Backed Securities Loan Facility). In a letter dated November 19, 2020, to Fed Chair Jerome Powell, the Secretary stated that the programs were little used and no longer needed, and that he believed that under the CARES Act Congress intended to permit the origination of new loans and the purchase of assets only through December 31, 2020. He therefore requested Powell to return the $195 billion in funds supporting these programs to the Treasury, effectively closing them to new activity. Commissioner Ramamurti asked that Secretary Mnuchin provide a written legal opinion to the commission supporting that action. See this YPFS blog for more discussion of this issue, including Powell's response.

Other Updates

The COC notes that the Federal Reserve continues to buy $20 million in bonds every day through the Secondary Market Corporate Credit Facility, which the Commission had recommended terminating in its fifth report. The November report reiterates that recommendation, stating that the facility is not needed anymore.

In response to COC criticism of the administration of the Main Street Lending Program (MSLP), the Federal Reserve announced on October 30 that the minimum loan size would be lowered from $250,000 to $100,000 for three of the five MSLP facilities. Also, the Fed adjusted the fee structures to be inversely proportional to loan size so that lenders would better accommodate smaller borrowers. The COC corresponded with City National Bank of Florida to better understand its role as provider of the majority of MSLP loans. According to City National Bank, an early investment in training staff to handle MSLP applications led to a significant uptake in program usage. However, the bank warned that many of its loans currently in the pipeline are at risk of not closing in time for the program's deadline of December 31.

Also, see this recent YPFS blog providing an update on the use of several of the Federal Reserve programs under the COC's jurisdiction.