

Compensation Alert

New Executive Compensation Rules for TARP Recipients

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 became law. In addition to other stimulus-related initiatives, the ARRA amends the Emergency Economic Stabilization Act of 2008. Recipients of the Troubled Asset Relief Program (TARP) must comply with new executive compensation restrictions and disclosure requirements.

Those impacted include the executive offices of the “C-Suite” and reach down to the next twenty highest paid employees of TARP recipient organizations. For those institutions that took lesser amounts under TARP, the restriction is on the highest paid, whether they are officers or not. The new restrictions will be reviewed retroactively by the Treasury Secretary and the federal government will seek reimbursement where excess compensation is exhibited. The Treasury Secretary has indicated that executive compensation reform may soon extend beyond TARP recipients and large publicly-held companies.

Requirements of Corporate Directors

ARRA requires a compensation committee of the board of directors must be established and must comprise of independent directorsⁱ. This committee is required to meet at least semi-annually to evaluate compensation plans of the company. Additionally, the committee must ensure that the compensation plans utilized throughout the entire organization do not result in payments to employees due to the manipulation of reported earnings or any other performance measure. This extends beyond executive pay and into payment of any compensation plan for any employee. Finally, the compensation committee is required to review and disclose employee compensation arrangements and explain how they are consistent with promoting “sound risk management” and long-term value creation.

The board of directors must adopt a written company-wide policy limiting “excess” expenditures related to aviation, transportation, office and facility renovation, entertainment, holiday parties, conferences, and similar events. Permissible exceptions apply to activities that are considered reasonable expenditures for the development of staff, performance incentives, sales conferences, or similar events conducted in the normal course of business. This policy must require authorization by the Chief Executive Officer of expenditures that could be interpreted as “excessive”.

Shareholders of TARP recipient companies are provided the right to vote annual approval of executive compensation as disclosed under current compensation disclosure rules. This vote is not binding on the board of directors and does not create additional fiduciary responsibility for the board of directors.

Requirements of Corporate Executives

Arguably the most significant restriction imposed by ARRA is the limit of total annual compensation of senior executive officers to \$500,000ⁱⁱ, plus restricted stock. There is a general prohibition of payment of bonuses, incentives, or retention awards other restricted stock or similar vehicles until repayment of the financial obligation. The restricted stock award (or similar long-term incentive) may not be greater in value than one-third of the annual compensation (\$500,000) of the senior executive. Further, the long-term incentive award may not vest until the financial assistance obligation to the federal government is fulfilled. The numbers of executives impacted by the long-term incentive restrictions are highlighted in the table below:

<u>TARP Assistance Received</u>	<u>Executives Restrictedⁱⁱⁱ</u>
Less than \$25,000,000	Most highly compensated employee only
\$25,000,000 - \$250,000,000	Five highest compensated employees
\$250,000,000 - \$500,000,000	Senior executive officers and the next ten highest compensated employees
\$500,000,000 and over	Senior executive officers and the next twenty highest compensated employees

Compensation plans for executives must now include “Clawback” provisions mandating the repayment of bonuses, incentives, or other compensation paid where knowing manipulation of performance measures occurred. The top twenty senior executives are subject to “clawback” provisions where inaccurate information related to financial statements or performance measures was intentionally utilized in the calculation of incentive pay.

A general prohibition is imposed on the payment of “golden parachute” or similar severance arrangements to senior executives. This prohibition applies to the senior executive officers and the next five most highly compensated employees^{iv}. Further, the next twenty-five executives are limited to severance in the amount of one year’s compensation.

A written statement of compliance with the executive compensation provisions must be issued annually by the Chief Executive Officer. Public companies will issue such statements to the shareholders and the Securities Exchange Commission (SEC). Companies not traded publicly will certify compliance with the Secretary of the Treasury.

There are many points that will have to be clarified through regulations. Companies are well advised to seek assistance from professionals to determine the impact on their organization and the highly-compensated individuals they employ.

Additional Trends

Over the next several months, expect continued activity in the arena of executive compensation moderation. Senator John Kerry has authored a Bill recommending a cap on executive compensation of one million dollars. The Secretary of the Treasury has indicated preferences of required stock ownership guidelines and minimum term requirements.

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ⁱ For TARP recipient companies that are non-SEC registered and that received \$25 million or less, the duties of the compensation committee may be carried out by the board of directors.

ⁱⁱ Companies that participate in generally available capital access programs may waive this rule by disclosure of their compensation.

ⁱⁱⁱ The Secretary may determine any number of additional employees restricted.

^{iv} For companies participating in the generally available capital access programs, the prohibition applies to the top five senior executives and limits severance to one year’s compensation.