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A Financial Institutions Legal Update

03/04/09

American Recovery and Reinvestment Act of 2009: Implications for Financial Institutions

On February 17, 2009, President Obama signed the history-making American Recovery and Reinvestment Act of 2009 (the "Act"). Designed to put the nation, and the world, on the road to economic recovery, the Act contains over one thousand pages of appropriations for existing and new programs. It also contains new requirements for utilizing these programs. Many sections of the Act require rulemaking and, in some cases, the establishment and staffing of new sub-agencies. Therefore, it may be some time before we know just how the programs will be implemented and the exact extent of the restrictions and requirements that may apply to them. In the meantime, what follows is a high level summary of those sections of the Act that should be of the most interest to financial institutions.

Executive Compensation Limits on Recipients of TARP Assistance

The Act amends the Emergency Economic Stabilization Act of 2008 to impose limits on compensation of employees of entities that have, or will, receive financial assistance under the Troubled Assets Relief Program ("TARP"). These restrictions:

- apply to financial institutions that receive any type of TARP assistance. The restrictions remain in effect while the assistance is still outstanding;
- prohibit incentives for senior executive officers[1] to take "unnecessary and excessive risks;"
- allow for the recovery of previously paid awards to the senior executive officers and the next 15 most highly-compensated employees, if any of the institution's financial statements are later found to be misleading;
- prohibit the payment of golden parachutes to the senior executive officers and the next five most highly-compensated employees; and
- prohibit bonuses or other incentive compensation (except long-term restricted stock awards) to certain highly-compensated employees. Which employees are covered under this incentive pay restriction depends on the amount of TARP assistance the institution receives:

[1] "Senior executive officers" are the five most highly paid employees and whose compensation must be publicly disclosed.

- Up to $25 million: Prohibitions apply to the most highly-compensated employee;
- From $25 million to $250 million: Prohibitions apply to at least the five most highly-compensated employees;
- From $250 million to $500 million: Prohibitions apply to the senior executive officers and at least the next ten most highly-compensated employees; and
- $500 million or more: Prohibitions apply to the senior executive officers and at least the next 20 most highly-compensated employees.

The Act grants the Secretary of the Treasury the authority to extend coverage of the incentive compensation limitations to additional employees. In addition, the exception for long-term restricted stock awards applies only if: 1) the award does not fully vest during the period in which the assistance is outstanding; 2) the award does not exceed more than one-third of the employee's total annual compensation; and 3) it meets other restrictions as the Secretary deems appropriate. The restrictions on bonuses and other incentive compensation also do not apply to payments made pursuant to written employment agreements executed on or before February 11, 2009. *In addition, the Act does not limit the salaries that can be paid to the institution's employees.*

The Act also requires each institution which receives more than $25 million in assistance to establish a separate Board Compensation Committee to regularly review the institution's compensation policies. The Board must be composed entirely of outside directors and must adopt policies on (and presumably prohibiting) luxury expenditures and other unreasonable spending. Finally, the Act requires annual shareholder approval of senior executive compensation, although the vote may be non-binding.

Small Business Act and Small Business Investment Act Changes

- The Act provides for the reduction of program fees for loans to small business concerns up until September 30, 2010.
- Under the Economic Stimulus Program for Small Businesses, the Small Business Administration ("SBA") will guaranty up to 90 percent of qualifying small business loans to eligible borrowers. The program sunsets on February 16, 2010.
- The SBA will establish the SBA Secondary Market Guaranty Authority ("SMGA"). The SMGA will guaranty up to $3 billion in pools of first lien Section 504 loans that are sold to third-party investors. Private sector entities may apply for the guaranties. The sellers must: 1) retain at least 5 percent of the pools; and 2) absorb any losses resulting from a shortage or excess of monthly cash flow. This program is set to expire on February 16, 2011.
- The Stimulus for Community Development Lending will provide funds for refinancing loans made to small business concerns. The loans must have been made to finance the expansion of such companies, and the loans and projects must meet other criteria. These

include that the borrower has been current for at least the previous 12 months and the refinancing will result in a more favorable interest rate.

- New Simplified Maximum Leverage Limits increase the SBA's purchases of small business investment companies' securities and guaranties of their debentures. The new maximum leverage limit to any one company cannot exceed the lesser of: 1) 300 percent of the company's private capital; or 2) $150 million. If two or more such companies are under common control (and not under capital impairment), the new limit is $225 million. Higher caps apply if the small business investment companies are licensed after February 17, 2009, and certify that at least half of their investments will be in low income areas. In addition, to obtain leverage, the licensee must certify that at least 25 percent of its investments will be in smaller enterprises.
- New Simplified Aggregate Investment Limitations apply when a small business investment company has obtained financing and the financing remains outstanding. The aggregate amount of securities acquired (and for which commitments may be issued) for any one company shall not exceed ten percent of the sum of: 1) the company's private capital; and 2) the total leverage projected when the company was licensed.
- A new Business Stabilization Program will provide loans to viable small business concerns that have outstanding loans guaranteed after February 17, 2009, and which are experiencing immediate financial hardship. These loans: 1) cannot exceed $35,000; 2) must be used to make periodic payments for up to six months; and 3) must be repaid within five years of the date of the loan. The loans will be fully guaranteed and interest will be deferred for the entire repayment period. No fees will be charged on the loans.
- The SBA will also establish as new Secondary Market Lending Authority ("SMLA") to provide loans to "Systemically Important Secondary Market Broker-Dealers" to be used to finance the portion of loans or pools of loans that are guaranteed by the SBA. The SMLA will develop a process to designate broker-dealers as "Systematically Important." Loans made under this program will be fully collateralized and will carry interest rates of up to 25 basis points over the Federal Funds Target Rate. This program is scheduled to sunset on February 16, 2011.

Other Sections of the ARRA

- The Act set a floor for FHA Loan Limits for 2009. Notwithstanding the further decline in home values, the limits for 2009 will be no less than for 2008. The Department of Housing and Urban Development ("HUD") has also been granted the authority to establish higher limits for "sub-areas" in which HUD believes that higher limits are appropriate.
- The GSE Conforming Loan Limits for 2008 will also be no less than those for 2008. In addition, the Housing Finance Agency may establish higher limits for some "sub-areas."
- The Act increases available insurance for FHA Reverse Mortgages.
- A new Homeowners Assistance Fund will provide assistance payments to homeowners near closed military bases. It will also provide assistance to wounded military and Defense Department personnel and their spouses. It further provides special assistance to military personnel being reassigned during the housing crisis.

- A new Community Development Fund will provide funds to rehabilitate foreclosed properties, and the Homelessness Prevention Fund will provide rental assistance to persons who have become homeless, including those homeless because of the foreclosure crisis.

Lane Powell has launched an interdisciplinary team comprised of attorneys from a wide range of practice areas to assist our clients in identifying key opportunities and challenges presented by the American Recovery and Reinvestment Act of 2009 and related administrative policies. Please visit our website to read additional legal updates prepared by members of Lane Powell's Economic Stimulus task force.

For more information, please contact the Financial Institutions Law Industry Team at Lane Powell:

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