Banking Law @ manatt

June 18, 2009

Treasury Issues Interim Final Rules for Recipients of TARP Funds

John J. Heber
David W. Herbst
Craig D. Miller
Eric S. Jones

On June 10, 2009, the Treasury Department issued in-depth guidance (the "Interim Final Rules") on the restrictions and requirements placed on firms receiving financial assistance under the Troubled Asset Relief Program ("TARP"). The Interim Final Rules provide detailed guidance in relation to executive compensation and corporate governance. The following summarizes what has been clarified and expanded by the Interim Final Rules:

Executive Compensation Matters

- Clarifies Executive Compensation Limitations for Certain Executives and Highly Compensated Employees at Companies Receiving TARP Funds
    - ***Prohibition on Incentive Payments***
        - As a general rule, TARP recipients are prohibited from accruing or paying any bonus, incentive compensation or retention award to certain executives and employees while TARP obligations remain outstanding. The number of employees that this rule applies to is based on the amount of assistance that the recipient has received. There are three exceptions to this rule: 1) payments of long-term restricted stock or restricted stock units (which may be payable in cash or stock) that do not have a value greater than one-third of the employee's annual compensation as determined for that

Newsletter Editors

Katerina Hertzog Bohannon
Partner
kbohannon@manatt.com
650.812.1364

Harold P. Reichwald
Partner
hreichwald@manatt.com
310.312.4148

Our Practice

Manatt was founded with a special emphasis on advising banking and financial services clients. Today we are one of the leading banking law firms in the United States, representing numerous banks, holding companies, foreign banks, savings institutions, mortgage lenders, finance lenders, credit card issuers, acquirers and processors and industrial loan companies ... more

. Practice Group Overview
. Practice Group Members

Info & Resources

. Subscribe
. Unsubscribe
. Sarbanes-Oxley Act
. Newsletter Disclaimer
. Manatt.com

fiscal year; 2) payments made under a legally binding contract that was executed on or before February 11, 2009; and 3) certain payments made before June 15, 2009 (or accrued for service prior to that date as long as payment is not made until after the recipient's TARP period has ended).

- ***Prohibition Against Golden Parachutes***
  - Prohibits a "golden parachute payment" to any senior executive officer and the next five most highly compensated employees during the TARP period made as a result of a departure for any reason from the TARP recipient (subject to limited exceptions, including death or disability) or as a result of change in control of the TARP recipient. The prohibition for a change in control (i.e., single trigger) is an expansion over the original rules contained in the American Recovery and Reinvestment Act of 2009 ("ARRA") which did not apply to changes in control where no departure occurred. In addition, a golden parachute payment includes the acceleration of vesting as a result of a departure or change-in-control event. Accordingly, provisions in an equity incentive grant that provide for acceleration of a previously granted stock option or restricted stock grant will not be able to be honored during the applicable TARP period. Furthermore, golden parachute payments are treated as paid at the time of the departure or change in control. As a result, a prohibited golden parachute payment can include amounts payable after a TARP recipient has returned all TARP funds.
- ***Bonus Clawback Protection***
  - Imposes a mandatory clawback for any bonuses to the senior executive officers and the next 20 most highly compensated employees that are based on materially inaccurate performance criteria.
- ***Prohibition on Certain Tax Gross-Up Payments***
  - Gross-up payments are not allowed for any senior executive officers and the next 20 most highly compensated employees. This is a significant expansion that was not

previously contained in ARRA.

- **Appoints Kenneth Feinberg as Special Master**
  - To do, including, but not limited to, the following: issue advisory opinions, negotiate for reductions of compensation when appropriate, interpret the executive compensation restrictions on TARP recipients.

As a practical matter, the Treasury is trying to restrict compensation in a way that discourages excessive risk-taking while still allowing firms to remain competitive in their industry. The Treasury has included nonexecutives in the definition of "most highly compensated employees." Therefore, recipients of TARP funds should immediately begin to evaluate which of their employees are subject to the above compensation restrictions. This may be difficult to do because it will require a careful analysis of the equity being provided to each employee.

One area of confusion that should be noted is whether or not the limitations imposed on TARP recipients would continue to apply to recipients in the U.S. Treasury's Capital Purchase Program, if, following redemption of the TARP preferred stock, the U.S. Government exercised any warrant to purchase common stock. Although the Interim Final Rules are very clear that the "TARP period" ends when the preferred stock is redeemed or otherwise repurchased by the TARP recipient, notwithstanding whether or not any warrant to purchase common stock remains outstanding, the Interim Final Rules are unclear as to what happens if the warrant is actually exercised. Although we believe the Treasury intended to disregard any common stock that may be issued upon exercise of such a warrant from restarting the TARP period, we will have to wait for clarification on that point from the Special Master.

Corporate Governance Matters

- **Requires Additional Perk Disclosure**
  - Within 120 days of the completion of a fiscal year, where TARP obligations remain outstanding, the TARP recipient is required to provide the Treasury and its primary regulatory agency a narrative containing the following: amount and nature of the perks; the recipient of the perks and the justification for offering the perks. This only applies to perks given to certain senior executive officers and highly compensated employees whose value exceeds $25,000.
- **Mandates Disclosure of Compensation Consultants**
  - Within 120 days of the completion of a fiscal

year, where TARP obligations remain outstanding, the compensation committee (or if one is not required, the board of directors) of each TARP recipient is required to provide the Treasury and its primary regulatory agency with a narrative stating whether a compensation consultant has been retained and a description of the services being provided by the consultant (including noncompensation-related services and any benchmarks or comparisons that were utilized).

- **Extends Required Risk Analysis of Compensation to All Employees of TARP Participants**
  - The TARP recipient is required to have a compensation committee, composed of independent directors, which must meet at least every six months to review the employee compensation plans and the risks they pose to the TARP recipient (or, in the case of certain private TARP recipients, such functions shall be completed by the board of directors). Furthermore, at least once a year, the compensation committee must provide a narrative description of every compensation plan and explain how (i) the plans do not encourage senior executive officers to take unnecessary and excessive risks, in the case of plans in which senior executive officers participate, and (ii) unnecessary risks posed by the employee compensation plan have been limited, in the case of plans in which all employees participate. Public companies must provide this disclosure in their Compensation Committee Report contained within their annual proxy statement.
- **Requires Luxury Expenditure Policies for All TARP Participants**
  - Within the later of 90 days after the closing date of the agreement for acquiring TARP funds or September 14, 2009, the board of directors must adopt an excessive or luxury expenditures policy. This policy must be provided to the Treasury and its primary regulatory authority, and be posted on the firm’s web site (if it has one). In addition, there are certain continuing disclosure and

term requirements.

- **Institutes "Say on Pay" Requirement for All TARP Participants**
  - The firm is required to allow a vote on executive compensation and to comply with any requirements imposed by the SEC related to "say on pay."
- **Additional Certification and Recordkeeping Requirements**
  - Certain senior executives of the firm are required to provide additional certifications, and the firm is required to keep certain records for at least six years after the certification.

TARP recipients should immediately consult counsel to ensure that they comply with the deadlines for disclosure/review of the following: perks, compensation consultants, risk analysis, luxury expenditure policy, "say on pay," certifications and recordkeeping requirements.

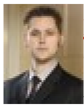
back to top

FOR ADDITIONAL INFORMATION ON THIS ISSUE, CONTACT:

John J. Heber Mr. Heber is an attorney who specializes in executive compensation and benefits programs for both domestic and international companies. Prior to joining Manatt, Mr. Heber led the Compensation and Benefits consulting practice at a Big 4 accounting firm. With his tax, legal, accounting and consulting background, Mr. Heber is able to advise on the tax, regulatory and strategic issues related to executive compensation and benefits programs.

David W. Herbst David Herbst is the head of Manatt's Northern California Business & Transactions practice. Mr. Herbst counsels public and private companies at the board, board committee and executive officer levels on a broad range of corporate, corporate governance and executive compensation matters. His practice emphasizes serving the needs of technology companies and financial institutions. Mr. Herbst has practiced in Silicon Valley his entire career, while regularly supporting clients of the firm's Southern California and East Coast offices as well.

Craig D. Miller Mr. Miller's practice focuses on representing public and private corporations and financial institutions in a wide range of sophisticated corporate matters, including mergers and acquisitions, public and private securities offerings and corporate governance issues, including compliance with the Sarbanes-Oxley Act and continued listing requirements promulgated by self-regulatory organizations. He also regularly represents venture capital funds and private companies in venture fund formation and equity offerings.



Eric S. Jones Mr. Jones is an associate with the Business, Finance & Tax practice group in the Los Angeles office. He has a broad-based tax practice in corporate, partnership, international and individual income tax, including mergers and acquisitions, reorganizations and dissolutions, choice of entity considerations, executive compensation, and transactional matters. His practice also includes the taxation of financial instruments, including debt and equity offerings of U.S. and non-U.S. companies (contingent principal debt instruments, variable rate debt instruments, debt vs. equity analysis, etc.).