Current Congressional Efforts to Restrict Compensation of TARP Participants

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On March 14, 2009, news media reported that American International Group, which had received more than $170 billion in government assistance under TARP, would honor obligations to pay approximately $165 million in retention awards to employees in its financial products unit. In response to public anger over these payments, several bills intended to curb the perceived excess compensation paid by TARP participants have been introduced in the House and Senate. This memorandum briefly summarizes the compensation provisions in those bills that have received the most attention and considers the bills' prospects for becoming law.

Background

The American Recovery and Reinvestment Act of 2009, enacted on February 17 and commonly referred to as the stimulus bill, contains provisions relating to compensation paid by institutions that receive TARP assistance. These provisions include restrictions on the amounts and forms of compensation payable, including prohibitions on payments of incentive compensation, other than long-term restricted stock, and golden parachute payments; provision for possible reimbursement of previously paid compensation; and a requirement that compensation be submitted to non-binding "say on pay" shareholder votes.[1] The stimulus bill requires the Treasury Secretary to promulgate regulations to implement the compensation requirements included in the bill. No deadline for the promulgation of these regulations is specified; however, there is speculation that guidance may be imminent.[2] The content of any such guidance may affect Congressional efforts to legislate with respect to compensation.

"Pay for Performance Act"

The Grayson-Himes "Pay for Performance Act" (H.R. 1664) was originally introduced by House Financial Services Committee Chairman Barney Frank on March 23 and was passed in amended form by the full House on April 1 by a vote of 247 to 171. The bill would prohibit covered institutions from paying "unreasonable or excessive" compensation or non-performance-based bonuses or other supplemental payments (including post-termination payments), other than longevity bonuses and payments in the form of restricted stock.[3] Severance paid in the ordinary course of business to an employee with at least five years of service would not be subject to the prohibition, so long as the amount of the severance did not exceed the lesser of such employee's annual salary or $250,000. The Treasury Secretary, with the approval of the member agencies of the Federal Financial Institutions Examination Council,[4] and in consultation with the Chairperson of the Congressional Oversight Panel,[5] would be required to establish standards implementing the prohibitions within 30 days after the bill's enactment.

The bill's prohibitions would apply to institutions with any outstanding TARP assistance, Fannie Mae, Freddie Mac and Federal home loan banks; however, the bill would authorize the Secretary to exempt any institution with $250 million or less of outstanding assistance. In addition, the prohibitions generally would not apply to any institution that had entered into a comprehensive agreement with the Secretary to repay to the U.S. government all of its outstanding TARP assistance.[6]

The bill would require each covered institution to provide the Secretary with an annual report detailing the compensation of each of its officers, directors and employees (on a no-names basis) receiving total compensation in that fiscal year of more than $500,000. The Secretary would be required to make the report available on the Internet.

The bill would also establish a "Commission on Executive Compensation" to study the executive compensation system for TARP participants and report its recommendations to the President and Congress within 90 days after the appointment of all its members. In making its recommendation, the Commission would be required to consider, among other things, "the effects of implementing increased shareholder voice in executive compensation."

Any action on the bill by the Senate is not expected until Congress returns from its spring recess on April 20, and its prospects for becoming law are uncertain.

For the text of the Pay for Performance Act, click here.

Bills Taxing Bonuses

Congress currently is considering several bills that would tax bonuses paid by TARP participants. The two bills that have received the most attention are those sponsored by Representative Charles Rangel and Senator Max Baucus.

Rangel Bill

The Rangel bill (H.R. 1586) was introduced in the House Ways and Means Committee on March 18, was passed by the full House the next day by a vote of 328 to 93 and was placed on the Senate calendar on March 23. The bill would increase to 90% the Federal income tax rate imposed on any "retention payment, incentive payment, or other bonus" paid to a current or former employee of a covered institution. The tax generally would not apply to the extent that the employee's adjusted gross income for the taxable year, including the aggregate amount of such payments, did not exceed $250,000.

Covered institutions would include:

- » institutions with more than $5 billion in outstanding TARP assistance and their corporate affiliates (based on an 80% vote and value stock ownership test);
- » Fannie Mae and Freddie Mac and their corporate affiliates; and
- » partnerships of which more than 50% of the capital or profits interests were owned directly or indirectly by one or more institutions described in the first two bullets above.

An institution with more than $5 billion in TARP assistance would cease to be covered at the time that it had repaid enough of such assistance so as to reduce the amount of its outstanding assistance to not more than $5 billion.

For the text of the Rangel bill, click here.

Baucus Bill

The "Compensation Fairness Act of 2009" (S. 651) was introduced by Senator Baucus on March 19. The bill would impose a 35% excise tax on a covered institution that pays a bonus to any of its directors, officers or employees and a 35% excise tax (in addition to ordinary income tax) on the individual who receives the bonus. The excise tax would be imposed on the entire amount of any "retention bonus" and on the portion of any non-retention bonus in excess of $50,000. The bill would also prohibit a covered individual from deferring compensation in excess of $1 million per year.

The Baucus bill's definition of a covered institution would generally mirror the Rangel bill's definition, except that the Baucus bill would cover institutions that have outstanding TARP assistance of more than $100 million, rather than $5 billion. In addition, the Baucus bill would not expressly apply to partnerships; however, the bill would provide the Treasury Secretary with authority to prescribe rules, regulations and guidance to prevent institutions from avoiding the excise taxes on excessive bonuses through the use of partnerships or other pass-through entities. An institution with more than $100 million in TARP assistance would cease to be covered following the end of the calendar year in which it had repaid enough of such assistance so as to reduce the amount of its outstanding assistance to not more than $100 million.

For the text of the Baucus bill, click here.

Prospects of Bills Taxing Bonuses

Commentators have questioned whether the Rangel and Baucus bills' taxation of bonuses would be unconstitutional, in particular as bills of attainder targeted at a specific person or group. Indeed, President Obama criticized the bills' approaches during an interview on the CBS news program "60 Minutes" episode that aired on March 22, expressing his belief that "you certainly don't want to use the tax code to punish people."[7] Due to such criticisms and the fact that anger over the AIG bonuses has receded somewhat following reports that many of the employees have decided to repay their bonuses, the prospects for the bills' becoming law may have diminished.

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1 A comprehensive review of the stimulus bill's compensation provisions can be found in our client memorandum Compensation Provisions in the American Recovery and Reinvestment Act of 2009, dated February 17, 2009.

2 Although Treasury has not yet issued guidance with respect to the stimulus bill's compensation provisions, the SEC has issued guidance clarifying that the bill's "say on pay" requirement generally applies with respect to this year's annual meeting proxy statement. A comprehensive review of this SEC guidance can be found in our client memorandum "Say on Pay" Now a Reality for TARP Participants, dated February 25, 2009. In addition, on March 31, the IRS issued Notice 2009-27, which provides guidance with respect to the stimulus bill's premium subsidy for COBRA health care continuation coverage.

3 Another bill (H.R. 1575) targeted at "excessive compensation" failed a vote of the full House on April 1. The bill, entitled the "End Government Reimbursement of Excessive Executive Disbursements (End GREED) Act," was introduced by Representative John Conyers on March 17. The bill would have authorized the Attorney General, after consultation with the Treasury Secretary, to seek recovery of previous excessive compensation paid by institutions receiving extraordinary government financial assistance and to limit future excessive compensation paid by such institutions.

4 The Federal Financial Institutions Examination Council consists of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

5 When Congress enacted the Emergency Economic Stabilization Act of 2008 on October 3, 2008 to provide Treasury with the authority to spend $700 billion to stabilize the U.S. economy, it also created the Congressional Oversight Panel to monitor and report to Congress on the implementation of the Act. The Panel's current Chairperson is Elizabeth Warren, Professor of Law at Harvard University.

6 The stimulus bill authorizes the Secretary, subject to consultation with the appropriate federal banking agency (the Federal Reserve, for any bank holding company), to permit an institution to repay any TARP assistance without regard to whether the institution has replaced such funds from any other source or to any waiting period.

7 At a press conference at the end of the G20 summit in London on April 2, President Obama spoke approvingly of the compensation principles outlined at the summit. The compensation principles included in the "Declaration on Strengthening the Financial System" adopted by the G20 at the summit require (i) "firms' boards of directors to play an active role in the design, operation, and evaluation of compensation schemes," (ii) "compensation arrangements, including bonuses, to properly reflect risk and the timing and composition of payments to be sensitive to the time horizon of risks," and (iii) "firms to publicly disclose clear, comprehensive, and timely information about compensation." SEC Chairman Mary Schapiro echoed some of these principles in a speech to the Council of Institutional Investors on April 6. She stated that the SEC will consider whether greater disclosure is needed about (i) "how a company — and the company's board in particular — manages risks, both generally and in the context of setting compensation," and (ii) "a company's overall compensation approach, beyond decisions with respect only to the highest paid officers, as well as compensation consultant conflicts of interests."

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If you have any questions regarding this memorandum, please contact any of the lawyers listed below or your regular Davis Polk contact.

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