Date: February 9, 2009

To: Interested Persons

Re: More Executive Compensation Restrictions Are Included in the Senate Stimulus Bill Expected to Pass Tomorrow

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Reflecting the political flash point that executive compensation has become, the Senate stimulus bill, which is expected to pass on Tuesday, includes a raft of new executive compensation restrictions that would apply to financial institutions receiving TARP assistance. Unlike the executive compensation guidelines announced by the Obama administration last week, which modulated the severity of the restrictions depending on whether a financial institution received "general" or "exceptional" assistance, the restrictions in the Senate bill reflect a "one size fits all" approach and would apply to all financial institutions that have received any TARP funds, no matter how small the amount or how widespread the program under which the TARP funds were received. While the Obama guidelines would apply only to financial institutions receiving future assistance, many of the restrictions proposed in the Senate bill would apply retroactively. Unlike the prior executive compensation restrictions, a number of the restrictions in the Senate bill apply to employees well beyond the senior executive officer group. These restrictions are in addition to any restrictions previously imposed and, if enacted, would severely limit the ability of the Treasury Department to design and implement its own guidelines either now or in the future.

After passage, the Senate bill will be referred to a House and Senate conference committee for reconciliation with the stimulus bill previously passed in the House. While the Senate's executive compensation restrictions are expected to survive the Senate vote, the outcome of the conference committee is uncertain. The Senate bill's executive compensation restrictions are a patchwork of overlapping provisions added by various Senators and, at a minimum, some internal reconciliation is appropriate. The stimulus bill passed on the House side did not include any executive compensation provisions, although the House has previously passed a separate bill, often referred to as the TARP II bill, which includes a number of executive compensation restrictions.

The Senate stimulus bill includes the following restrictions:

- Any financial institution that receives any future assistance under TARP, or seeks to amend the terms of any TARP assistance previously received, will thereafter have to ensure that no director, executive or other employee of the institution is permitted to receive annual compensation in excess of the compensation of the U.S. President (presently $400,000), for as long as the assistance remains outstanding. Virtually all forms of compensation and retirement benefit accruals and contributions will be counted against the $400,000 limit. This restriction is quite different from the Obama administration's guideline of $500,000, which permits restricted stock and other non-cash compensation above the $500,000 limit and allows a financial institution that has not received "exceptional" assistance to avoid this restriction by subjecting its compensation arrangements to a nonbinding vote of approval by its shareholders, a so-called "say on pay" vote. Neither the House stimulus bill nor the House TARP II bill includes any similar annual pay limit.

- For every financial institution that has previously received any assistance under TARP, whether or not the institution seeks to amend such assistance or receive additional assistance, the Treasury will review all bonuses, retention awards and other compensation paid by the institution to determine whether any such payments were excessive, inconsistent with the purposes of TARP or the stimulus bill, or otherwise contrary to the public interest and, if so, will negotiate with the institution and the relevant employees for reimbursement to the Treasury for such amounts. The bill does not indicate how far back this review should look.

- Separately, every financial institution that has previously received any assistance under TARP would be required to redeem an amount of preferred stock previously acquired by the Treasury from such institution equal to the aggregate amount of the 2008 bonus paid to any employee of the institution in excess of $100,000. To the extent that an institution fails to redeem the Treasury's preferred stock as required, the institution will be subject to an excise tax equal to 35% of the amount not redeemed. Presumably, any bonus amounts that have been reimbursed will be exempt, as will any portion of a bonus paid in stock or an interest in troubled assets held by the institution. Nothing like this appears in either the House stimulus or TARP II bill or in the Obama administration guidelines.

- Every institution that has received or will receive assistance under TARP must comply with the following limitations for as long as the TARP assistance remains outstanding to the institution:

    - The institution may not pay or accrue any future bonus, retention award or other incentive with respect to any of the institution's top 25 most highly compensated employees and such other employees that the Treasury may add to this group.

Under this restriction and several others, the provisions of the bill do not indicate how the affected group of employees is to be determined. For example, if an institution ceases to provide incentives to a group of employees, those employees may cease to be the most highly compensated. No similar restriction is contained in the Obama guidelines, but a similar restriction is included in the House's TARP II bill.

- The institution may not pay any severance benefits to its CEO, CFO or its next seven most highly compensated employees. By comparison, under the Obama guidelines, an institution receiving "general" assistance would be permitted to pay severance of up to one times annual pay to its top five executives and would not be subject to any severance limit for other employees, while an institution receiving "exceptional" assistance would be prohibited from paying any severance to its top 10 executives and would be limited to severance of one times annual pay for its next 25 most highly compensated executives. The House's TARP II bill includes a severance provision pertaining only to an institution's top five executives, although it is unclear whether the House provision would prohibit any severance to the top five or would permit severance up to a limit.

- If the institution has publicly traded equity, it must submit the compensation of its executives to an annual, nonbinding say on pay vote. Although unclear, the vote might have to apply only to the compensation of the institution's named executive officers whose compensation is disclosed in the annual proxy statement. The SEC is required to formulate rules for the say on pay vote within one year of the bill's passage. It is unclear whether the say on pay requirement will apply to annual proxy statements mailed prior to finalization of SEC rules. Under the Obama guidelines, a similar say on pay requirement would apply to any institution receiving "exceptional" assistance, while an institution receiving "general" assistance would also be subject to a say on pay vote if it wished to avoid the $500,000 annual pay limit under the Obama guidelines. The House bills contain no say on pay proposals, although say on pay has been included in a variety of bills introduced in the House over the last year or so.

- The board of directors of the institution must adopt a company-wide policy on expenditures related to aviation services, office and facility renovations, entertainment and holiday parties and other activities or events that are not reasonable business expenditures. A similar provision appears in the Obama administration guidelines, but there is no similar provision in the House bills.

- The institution would be subject to a number of other requirements, including new provisions relating to a clawback of compensation in the event of a material error in the financial calculations on which such compensation was based; a review of compensation arrangements to ensure that they do not promote manipulation of earnings; and CEO certification that the executive compensation restrictions are being met.

If you have any questions, please contact any of the lawyers listed below.

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