

# FINANCIAL SERVICES ALERT

Goodwin Procter LLP, a firm of 900 lawyers, has one of the largest financial services practices in the United States.

[SUBSCRIBE](#)

[CONTACT US](#)

[BACK ISSUES OF FSA](#)

[CONSUMER FINANCIAL SERVICES ALERT](#)

[OTHER PUBLICATIONS](#)

## EDITORS

[Gregory J. Lyons](#)

[Eric R. Fischer](#)

[Jackson B.R. Galloway](#)

[Elizabeth Shea Fries](#)

## SPECIAL EDITION

### Treasury Releases Interim Final Rule on Compensation and Corporate Governance Standards for TARP Recipients

The Treasury has released an interim final rule on compensation and corporate governance standards for Troubled Asset Relief Program (“TARP”) recipients (the “Interim Final Rule”). The Interim Final Rule implements the executive compensation and corporate governance provisions applicable to TARP recipients (collectively, the “Compensation and Governance Rules”) under the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009. The Interim Final Rule revises and replaces in its entirety the previous Treasury guidance implementing the Compensation and Governance Rules, consolidates all of the Compensation and Governance Rules into a single rule, and adopts a few additional standards that will also be applicable to TARP recipients.

*Determination of SEOs and Highly Compensated Employees.* The Compensation and Governance Rules generally apply to a TARP recipient’s senior executive officers (“SEOs”) and/or its most highly compensated employees. To fall within either category, an individual must be an employee (*e.g.*, not exclusively a partner of a partnership) of the TARP recipient (or any entity that is part of the same controlled group with the TARP recipient, determined using a 50% ownership test).

The SEOs for a year are those “named executive officers” (*i.e.*, the TARP recipient’s principal executive officer (“PEO”), principal financial officer (“PFO”) and certain other executive officers) who are identified in a public company TARP recipient’s annual report or proxy statement for that year, reporting compensation for the immediately preceding fiscal year. A private company TARP recipient is required to determine its SEOs by using the same general methodology used by public companies to determine their “named executive officers.”

For each year, the most highly compensated employees of a TARP recipient are those employees whose annual compensation is the highest among all of the TARP recipient’s employees. Annual compensation generally includes all compensation earned (regardless of whether the compensation is reported for Federal income tax purposes) by each employee in the immediately preceding fiscal year. The amount of compensation is determined in accordance with the same methodology that public companies use to determine their “named executive officers.” Only individuals who are employees of the TARP recipient on January 1 of a year may be a most highly compensated employee for such year.

*Limitations on Bonus Payments.* The Compensation and Governance Rules prohibit a TARP recipient from paying or accruing any bonus, retention award or incentive

## Disclaimer:

This publication, which may be considered advertising under the ethical rules of certain jurisdictions, is provided with the understanding that it does not constitute the rendering of legal advice or other professional advice by Goodwin Procter LLP or its attorneys.

## IRS Circular 230 Notice:

To ensure compliance with requirements under Treasury Department Circular 230, we inform you that the contents of this *Alert* are not intended or written to be used, and may not be used, for the purpose of (i) avoiding U.S. federal tax penalties or (ii) promoting, marketing or recommending to another party any matter addressed herein. Each taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax adviser.

©2009 Goodwin Procter LLP  
All rights reserved.

compensation during the TARP period (*i.e.*, the period beginning on the date the TARP recipient first receives financial assistance and ending on the last date upon which any obligation, other than common stock warrants, arising from such assistance remains outstanding) to certain employees. The TARP recipient's amount of financial assistance determines the number of employees (from one to 25 individuals) subject to this prohibition. These limitations do not apply to any payment required to be paid under a valid employment contract executed on or before February 11, 2009 which is paid in accordance to its terms.

An individual that falls within the prohibited group may not receive a bonus payment, retention award or incentive compensation payment, other than an award of restricted stock or restricted stock units (which may be settled in cash or in stock) with a value that does not exceed one-third of the individual's total annual compensation. For purposes of determining the individual's total annual compensation, the equity award is included and is valued based on the fair market value of the underlying equity on the grant date. For example, an individual whose annual compensation (*e.g.*, base salary) is \$1 million (prior to receiving the equity award), may receive a restricted stock award with a fair market value of up to \$500,000.

The restricted stock/unit award must not fully vest until the repayment of all financial assistance by the TARP recipient. The Interim Final Rule imposes a minimum vesting period of at least two years and prescribes the following schedule under which the stock may become transferable (or payable in the case of a restricted stock unit): for each 25 percent of total financial assistance repaid, 25 percent of the grant may become transferable, until the final repayment, at which time the remaining restricted stock/unit may become transferable.

The Interim Final Rule defines bonus, retention award or incentive compensation very broadly to cover all compensation for services rendered by an employee, with limited exceptions. Commissions payable in connection with direct sales of a product or service to unrelated customers in the ordinary course of business of the TARP recipient, including commissions paid for investment management services, are permissible payments. In addition, benefits accrued under a pre-existing deferred compensation plan are generally permitted to be paid. Examples of prohibited payments include the following:

- signing bonuses;
- “make-whole” payments;
- transaction bonuses;
- retention bonuses;
- equity awards (other than restricted stock/units that meet the amount, vesting and transferability restrictions described above); and
- loan forgiveness.

The Interim Final Rule also contains an anti-abuse provision which prohibits TARP recipients from providing “make-up” payments to prohibited individuals after the TARP restrictions no longer apply.

*Claw-backs.* TARP recipients are required to ensure that any bonus payment made to an SEO or the next 20 most highly compensated employees during the TARP period is subject to “claw-back” by the TARP recipient if the bonus payment was based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria. A TARP recipient is required to exercise its claw-back rights except in limited circumstances.

*Golden Parachutes.* A TARP recipient may not pay any “golden parachute payment” to an SEO or any of the next five most highly compensated employees during the TARP period. The Interim Final Rule defines a “golden parachute payment” for this purpose to be any payment, including the acceleration of vesting of equity awards or other compensation, in connection with a departure from employment or due to a change in control of the TARP recipient, other than certain payments from qualified or similar plans. A golden parachute payment does not include certain payments for current or prior services that would be made regardless of whether the employee departs or a change in control event occurs, including certain payments from welfare benefit plans and deferred compensation plans if specific requirements are satisfied.

*Perquisite Disclosure.* The Interim Final Rule adds a new requirement for TARP recipients to annually disclose any perquisites with a value in excess of \$25,000 for each of the SEOs and those most highly compensated employees who are subject to the limitations on bonus payments (described above). This disclosure must include a description of the amount and nature of the perquisites, the names of the recipients, and a justification for offering such perquisites. The disclosure must be provided during the TARP period to the Treasury and the TARP recipient’s primary regulatory agency within 120 days after the end of each fiscal year.

*Compensation Consultant Disclosure.* The Interim Final Rule adds a new requirement under which a TARP recipient’s compensation committee (or board of directors if the TARP recipient is not required to have a compensation committee) must annually disclose whether the TARP recipient, its board of directors or its compensation committee engaged a compensation consultant. The disclosure must include a description of all of the services provided by the compensation consultant and its affiliates during the past three years. The disclosure must be provided during the TARP period to the Treasury and the TARP recipient’s primary regulatory agency within 120 days after the end of each fiscal year.

*Prohibition on Gross-ups.* The Interim Final Rule adds a new requirement under which a TARP recipient is prohibited from providing any gross-ups to its SEOs and next 20 highest compensated employees. For this purpose, a “gross-up” is defined as any reimbursement for taxes owed with respect to any compensation, other than certain payments under a tax equalization agreement.

*Excessive or Luxury Expenditures Policy.* The board of directors of a TARP recipient must adopt and maintain an excessive or luxury expenditures policy, provide such policy to the Treasury and its primary regulatory agency, and post the policy on the company website. The Interim Final Rule provides that the excessive or luxury expenditures policy must apply to the TARP recipient and all of its employees and must cover expenses relating to entertainment or events, office and facility renovations, aviation or other transportation services and other similar items. The written policy must address expenditures that are prohibited and expenditures which require prior approval. The excessive or luxury

expenditures policy must be adopted within 90 days after first becoming a TARP recipient, or for current TARP recipients, by no later than September 14, 2009.

*Shareholder “Say on Pay” Resolutions.* TARP recipients are required to include a nonbinding shareholder resolution in any proxy, consent or authorization for an annual meeting of shareholders to approve the disclosed compensation of executives. This requirement was effective for proxies issued after February 17, 2009. The SEC is authorized to issue additional rules and regulations necessary to implement this requirement.

*Deduction Limit.* Certain TARP recipients are subject to Section 162(m)(5) of the Internal Revenue Code, which generally limits the deductibility of compensation paid to the CEOs to \$500,000 per year. Since the Interim Final Rule does not address this deduction limit, it is expected that the provision remains unchanged.

*Acquisitions, Mergers and Other Transactions.* The Interim Final Rule includes guidance on how the Compensation and Governance Rules will apply when a TARP recipient is acquired in an acquisition of almost any form by an unaffiliated entity that is not otherwise a TARP recipient. In such event, the acquirer will not become subject to the Compensation and Governance Rules merely as a result of the acquisition. In addition, none of the acquirer’s employees, including employees of the target (*i.e.*, employees of the acquired TARP recipient) who were CEOs or most highly compensated employees immediately prior to the transaction and who become employees of the acquirer as a result of the acquisition, will be subject to the Compensation and Governance Rules after the acquisition. The Interim Final Rule does, however, include an anti-abuse rule that provides that the acquirer and its employees (including applicable employees of the target) will be treated as a TARP recipient and subject to the Compensation and Governance Rules if the primary purpose of the acquisition is to avoid or evade the Compensation and Governance Rules.

*Compensation Committee Plan Review and Risk Assessment.* The Interim Final Rule clarifies that a TARP recipient must maintain a compensation committee consisting entirely of independent directors throughout the TARP period. Independence is determined pursuant to rules under the federal securities laws. Most publicly traded TARP recipients will already comply with this requirement. A privately-held TARP recipient receiving \$25 million or less in TARP assistance is not required to establish an independent compensation committee and the compensation committee’s duties (*e.g.*, the risk assessment and other duties described below) may be undertaken by the full board of directors.

The Interim Final Rule also expands the compensation committee’s duties. Specifically, at least semiannually, the committee must meet to review and evaluate CEO and employee compensation plans and arrangements. The purpose of the review is to ensure that such plans do not encourage unnecessary or excessive risks that threaten the value of the TARP recipient and do not encourage the manipulation of earnings in order to enhance compensation. During this review the compensation committee must identify and take necessary steps to limit risks created by such compensation plans. Furthermore, at least once per year, the compensation committee must provide a written narrative description explaining how such compensation plans do not encourage unnecessary or excessive risk, including how such plans will encourage long-term value creation over short-term results and the steps the TARP recipient has taken to limit risks concerning its compensation plans.

**PARTNERS AND COUNSEL**

[Marco E. Adelfio](#)  
[Lynne B. Barr](#)  
[Gary A. Beller](#)  
[Raymond P. Boulanger](#)  
[Agnes Bundy Scanlan](#)  
[Margaret B. Crockett](#)  
[Anna E. Dodson](#)  
[Eric R. Fischer](#)  
[Elizabeth Shea Fries](#)  
[Jackson B.R. Galloway](#)  
[John Hunt](#)  
[James J. Kelly](#)  
[Satish M. Kini](#)  
[Robert M. Kurucz](#)  
[Thomas J. LaFond](#)  
[Paul W. Lee](#)  
[Gregory J. Lyons](#)  
[Robin J. H. Maxwell](#)  
[William P. Mayer](#)  
[Philip H. Newman](#)  
[Sean P. O'Malley](#)  
[Christopher E. Palmer](#)  
[Byron C. Pavano](#)  
[Regina M. Pisa](#)  
[Mark S. Raffman](#)  
[Derek N. Steingarten](#)  
[William E. Stern](#)  
[Kimberly K. Vargo](#)  
[Michael P. Whalen](#)

*Compensation Committee Certification and Disclosure.* The compensation committee of a TARP recipient must certify, at least once per fiscal year, that it has discussed, evaluated and reviewed the CEO and employee compensation plans with the TARP recipient's senior risk officers at least every six months. Public company TARP recipients must provide the certification and disclosure to the Treasury and include them in the Compensation Committee Report. Private company (or smaller reporting company) TARP recipients must provide the certification and disclosure to the Treasury and the TARP recipient's primary regulatory agency within 120 days after the end of each fiscal year.

*PEO and PFO Certifications.* Within 90 days following completion of each fiscal year, the PEO and PFO must each certify as to compliance with all of the Compensation and Governance Rules. Public company TARP recipients should provide these certifications to the Treasury and include them as an exhibit to their annual reports on Form 10-K. Private company TARP recipients should provide these certifications to the Treasury and their primary regulatory agency.

*Special Master for TARP Executive Compensation.* The Interim Final Rule establishes the Office of the Special Master for TARP Executive Compensation (the "Special Master"). The Special Master is appointed by the Secretary of the Treasury and is responsible for the following:

- interpreting the Compensation and Governance Rules and other relevant guidance;
- reviewing bonuses, retention awards and other compensation paid prior to February 17, 2009 to employees of entities receiving TARP assistance prior to such date;
- approving compensation payments and structures for employees of TARP recipients receiving exceptional financial assistance; and
- providing advisory opinions.

*Effective Date and Comment Period.* The Interim Final Rule became effective on June 15, 2009, and is subject to a 60-day comment period that will end on August 14, 2009.