Interim Final Rule on TARP Standards for Compensation and Corporate Governance

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tg-165

1. ***Limits Executive Compensation for Certain Executives and Highly Compensated Employees at Companies Receiving TARP Funds***

· Limits Bonus Payments to Protect Taxpayer Investments

· Curtails the Payment of Golden Parachutes

· Imposes a Clawback for Any Bonus Based on Materially Inaccurate Performance Criteria

2. ***Appoints a Special Master to Review Compensation Plans At Firms Receiving Exceptional Assistance***

· Responsible for Reviewing Any Compensation for Senior Executive Officers and Most Highly Paid Employees At Firms Receiving Exceptional Assistance – With Authority to Disapprove Plans Where Salary or Other Compensation Is Inappropriate, Unsound or Excessive

· Must Approve Compensation Structure for Any Executive Officers and the 100 Most Highly Paid Employees at Those Firms

· Possesses Authority to Negotiate Reimbursements on Payments Made Before February 17, 2009

· Makes Determinations Based on A Clear Set of Principles

3. ***Implements and Expands Upon Key Recovery Act Provisions Consistent With February 4 th Proposals***

· Extends Required Risk Analysis of Compensation to All Employees of TARP Firms

· Requires Luxury Expenditure Policies for All TARP Firms

· Institutes "Say on Pay" Requirement for All TARP Firms

4. ***Sets Additional Compensation and Governance Standards to Improve Accountability and Disclosure***

· Prohibits Tax Gross-Ups

· Requires Additional Perk Disclosure

· Mandates Disclosure of Compensation Consultants

1. ***Limitations on Executive Compensation for Companies Receiving TARP Assistance:*** The interim final rule establishes certain standards for executive compensation practices at firms receiving TARP assistance, in order to fully protect the interests of taxpayers and mandate compensation practices that maximize the value of the firm for shareholders.

· ***Limits Bonus Payments to Senior Executive Officers and Highly Compensated Employees to Protect Taxpayer Investments*****:** The new regulations limit bonuses paid to senior executive officers – defined to include the "named executive officers" identified in the company's annual compensation disclosures – and to a specified number of t he most highly compensated employees of TARP recipients to one-third of total compensation, implementing the provisions passed by Congress. (The rule defines "most highly compensated" employees by reference to total annual compensation as calculated under the securities regulations, in order to most accurately capture the amounts earned by these executives each year. The number of most highly compensated employees covered by the limit depends upon the amount of financial assistance the company has received. For those institutions receiving over $500 million in assistance, the five senior executive officers and the 20 most highly compensated employees are covered.) At the same time, the rules encourage firms to pay salary in the form of stock that must be held for a long period of time and may not be entirely converted to cash until TARP funds are repaid, aligning executives' incentives with those of shareholders and taxpayers and effectively ensuring that executives experience a "clawback" effect if positive results prove illusory and the stock drops in value.

o ***Prevents Abuse of the Exception for Commissions*:** Although the rule contains an exception from the bonus limitation for payments of certain types of "commissions," the rule also minimizes abuse of the exception by limiting commissions to amounts payable under programs similar to commission programs already in place as of February 17, 2009. At firms re ceiving "exceptional assistance" under TARP, these payments and compensation structures for executive officers and the most highly compensated employees will also be subject to review by the newly appointed Special Master for TARP Executive Compensation.

· ***Curtails the Payment of "Golden Parachutes."*** The Recovery Act expanded the original EESA's limits on golden parachutes, prohibiting any golden parachute payment to a senior executive officer or any of the next 5 most highly compensated employees. While the Recovery Act limited the definition of golden parachutes to payments for an employee's departure for any reason , today's rule also includes payments made in connection with a change in control of the company.

· ***Imposes a Clawback for Any Bonus Based on Materially Inaccurate Performance Criteria***. Although the original EESA required a clawback provision applicable only to amounts paid to senior executive officers, the Recovery Act mandates that bonuses paid to senior executive officers and next 20 most highly compensated employees be subject to a clawback if the payment was based on materially inac curate performance criteria. Today's rule also requires that the TARP recipient actually exercise its clawback rights in such a case unless the TARP recipient can demonstrate that it would be unreasonable to do so (for example, if the expense of enforcing the clawback right exceeds the benefits of doing so).

2. ***<u>Appoints a Special Master to Ensure Compensation Plans Are Consistent with the Public Interest:</u>*** As part of the rule, we'll be announcing the appointment of Kenneth R. Feinberg as the Special Master for TARP Executive Compensation. In this role, Mr. Feinberg – a highly-respected mediator widely praised for his leadership of the September 11 th Victim Compensation Fund – will review payments and compensation plans for the executives and the 100 most highly compensated employees of TARP recipients that have received exceptional assistance to ensure that compensation is structured in a way that gives those employees incentives to maximize long-term shareholder value and protect taxpayer interests. Companies receiving exceptional financial assistance include those receiving assistance under the Programs for Systemically Significant Failing Institutions, the Targeted Investment Program, the Automotive Industry Financing Program, and currently include AIG, Citigroup, Bank of America, Chrysler, GM, GMAC and Chrysler Financial.

· ***Responsible for Reviewing Any Compensation for Senior Executive Officers and Next 20 Most Highly Compensated Employees at Firms Receiving Exceptional Assistance:*** At firms receiving exceptional assistance, the Special Master will be charged with reviewing and approving any compensation proposed to be paid to any employee subject to the Recovery Act's bonus restrictions (for these firms, this generally will include the five senior e xecutive officers and the 20 next most highly paid executives).

· ***Must Approve Compensation Structure for Senior Executive Officers and the 100 Most Highly Paid Employees at Those Firms:*** In light of the need for long-term reform of the structure of executive compensation and the incentives that pay gives to top executives, the Special Master will also be empowered to review and approve the structure of compensation for the 100 most highly paid employees that are not subject to the bonus res trictions and any executive officers that are not among the 100 most highly paid employees. Where the Special Master finds that the structure of compensation is inconsistent with the purposes of EESA, the TARP or the public interest, the Special Master may disapprove the plan and require the company to resubmit.

· ***Authority to Disapprove Compensation Arrangements for Companies with Exceptional Assistance Where Salary or Other Compensation Is Found to be Inappropriate, Unsound or Excessive:*** If the Special Master finds the salaries or any other compensation of those executives or employees subject to the bonus limitations in companies receiving exceptional assistance to be excessive, inappropriate or designed to encourage unsound risk-ta king, the Special Master has the authority to disapprove the arrangement and require the company to resubmit taking account of the deficiencies found by the Special Master. For any other of the executive officers and the 100 most highly paid employees, the Special Master may review the structure of the entire compensation package.

· ***"Safe Harbor" Guidance on Compensation Payments and Structure***: Consistent with the Treasury's February 4 guidance on executive compensation at TARP recipients, the Special Master will automatically approve proposed compensation to employees of TARP recipients receiving exceptional assistance so long as the employee's total annual compensation is not more than $500,000, with any additional compensation paid in the form of long-term restricted stock. Providing recipients with a clear "safe harbor" rule will encourage TARP recipients to use compensation structures that link compensation to long-term firm value.

· ***Entrusted With Negotiating Reimbursements for Taxpayers***: The Special Master will also oversee the review of bonuses, retention awards, and other compensation paid before February 17, 2009 by TARP recipients, and, where appropriate, negotiate appropriate reimbursements to the Federal Government.

· ***Issuing Determinations Based on a Clear Set of Principles:*** The IFR sets out a clear set of general principles that the Special Master will use to help determine whether TARP participants receiving exceptional assistance have designed executive compensation to maximize shareholder value and protect taxpayer interests, summarized as follows:

o ***Risk***: Compensation should avoid incentives that reward employees for short-term or temporary increases in value that may not ultimately result in an increase in the long-term value of the TARP recipient;

o ***Taxpayer Return***: Compensation should reflect the need for the TARP recipient to remain a competitive enterprise and ultimately repay TARP obligations;

o ***Appropriate Allocation***: Compensation should be appropriately allocated among each element of pay (*e.g.* salary, short- and long-term incentive pay, and current and deferred compensation or retirement pay);

o ***Performance-Based Compensation***: Compensation should be performance-based, and determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or relevant business unit;

o ***Comparable Payments***: Compensation should be consistent with, and not excessive in comparison to, pay for those in similar roles at similar entities; and

o ***Employee Contribution***: Compensation should reflect the current or prospective contributions of the employee to the value of the TARP recipient.

3. ***Implements and Expands Upon Key Recovery Act Provisions Consistent with February 4th Proposals:*** The rule expands upon key Recovery Act provisions in light of Treasury's February 4th proposals and the clear need for shareholders and directors to work together to ensure that compensation practices at TARP recipients are reformed over th e long term.

· ***Extends Required Risk Analysis of Compensation to All Employees:*** The original EESA included a requirement that compensation plans for senior executive officers be limited to avoid incentives for unnecessary risk-taking, and the Recovery Act expanded that provision to all employee compensation plans, and also to require that no employee compensation plan encourage the manipulation of earnings. Today's rule expands upon those important provisions by requiring that the compensation committee of the financial institution provide a narrative explanation of its analysis, allowing shareholders to determine and evaluate directors' reasoning with respect to the risks presented by compensation plans.

· ***Requires Luxury Expenditure Policies for All TARP Firms:*** The rule implements the Recovery Act's requirement that the board of directors of each TARP recipient put in place a company-wide policy on luxury or excessive expenditures. To help ensure that the top executives of each company keep close watch over these types of expenditures, the rule also requires that the CEO and the CFO of e ach TARP recipient certify that any expenditure requiring the approval of the board of directors or a senior executive officer or any executive officer of a substantially similar level of responsibility, was properly approved, and requires that the policy mandate prompt internal reporting of any violations of the policy.

· ***Institutes "Say on Pay" Requirement at All TARP Recipients:*** Consistent with our February 4th proposals, the Recovery Act requires that TARP recipients provide an annual shareholder vote on a non-binding resolution to approve executive compensation packages. Today's rule requires TARP recipients to permit such a vote consistent with regulations or guidance promulga ted by the SEC.

4. ***Sets Additional Compensation and Governance Standards to Improve Accountability and Disclosure for TARP Recipients:***Beyond new guidance on the provisions explicitly required by Congress, today's rule includes the following additional requirements to further protect shareholder value and enhance transparency at TARP firms:

· ***Prohibits Tax Gross-Ups:*** The rule prohibits the payment to senior executive officers and the 20 next most highly compensated employees of a tax "gross-up," or a payment to cover taxes due on compensation such as golden parachutes and perquisites. Studies indicate that the costs of these payments generally outweigh the benefits they provide to executives, and this additional requirement reflects the need for the structure of compensation arrangements to maximize shareholder value.

· ***Requires Additional Disclosure of Perks:***Expanding upon SEC disclosure requirements, TARP recipients will be required to disclose any perquisites provided to any employee subject to the Recovery Act's bonus limitations with total value exceeding $25,000. TARP recipients will also be required to provide a nar rative description of, and justification for, the benefit. Existing SEC rules require disclosure of perquisites to the five named executive officers of the company. By expanding the disclosure to include all employees subject to the bonus limitation, and by requiring a narrative discussion of the basis for providing the benefit, the rule will help the owners of the company better understand why directors have provided perquisites to employees -- and whether these perquisites are likely to maximize shareholder value.

· ***Mandates the Disclosure of Compensation Consultants:*** In light of the extensive involvement of compensation consultants in setting pay for top executives, the rule requires TARP recipients to disclose whether the company or its compensation committee engaged a compensation consultant. In order to give shareholders a more clear sense of the consultant's influence over pay and any possible conflict of interest, the rule requires TARP recipients to provide a narrative description of the services provided by any such consultant, including any non-compensation related services provided by the consultant or any of its affiliates, as well as a description of the use of any "benchmarking" procedures in the consultant's analysis.

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